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Notes to the Basic Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Commonwealth of Massachusetts (Commonwealth) have been prepared in accordance with accounting principles generally accepted in the United States of America, (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The significant Commonwealth accounting policies are described below. Except where noted, all numbers in the footnote tables and other sections of this Comprehensive Annual Financial Report are in thousands.

A. Reporting Entity

The Commonwealth is comprised of three branches: the Executive Branch, with the Governor as the chief executive officer; the Legislative Branch, consisting of a Senate of 40 members and a House of Representatives of 160 members; and the Judicial Branch made up of the Supreme Judicial Court, the Appeals Court and the Trial Court. In addition, the Legislature has established 57 independent authorities and agencies. Below the level of state government are 351 cities and towns exercising the functions of local governments. The cities and towns of the Commonwealth are also organized into 14 counties, but county government has been abolished in seven of those counties in recent years.

For financial reporting purposes, the Commonwealth has included all funds, organizations, account groups, agencies, boards, commissions and institutions. The Commonwealth has also considered all potential component units for which it is financially accountable as well as other organizations for which the nature and significance of their relationship with the Commonwealth is such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. As required by GAAP, these financial statements present the Commonwealth of Massachusetts (the primary government) and its component units. The Commonwealth has included 36 entities as component units in the reporting entity because of the significance of their operational and/or financial relationships with the Commonwealth.

Component Units and Details of Departments and Entities that are Separately Audited

Blended Component Units – Blended component units are entities that are legally separate from the Commonwealth but are so related to the Commonwealth, that they are, in substance, the same as the Commonwealth or entities providing services entirely or almost entirely to the Commonwealth. The net assets and results of operations of the following legally separate entities are presented as part of the Commonwealth's operations:

- **The Massachusetts School Building Authority (MSBA)** is charged with administering and funding a program for grants to cities, towns and regional school districts for school construction and renovation projects. The MSBA enabling statute eliminated the school building assistance program which was in existence since 1946. The revenues of the MSBA are derived from dedicated sales tax revenues and Commonwealth general obligation debt and MSBA bond proceeds. Their expenditures are on behalf of the Commonwealth. The MSBA's operations and results thereon are reported as a non-major governmental fund.

- **The Pension Reserves Investment Trust Fund (PRIT)** is the investment portfolio for the pension net assets of the Commonwealth and as such, is presented as a blended component unit. PRIT is managed by the Pension

Reserves Investment Management (PRIM) Board. Certain portions related to municipal holdings of PRIT are reported as an external investment trust within the fiduciary statement of net assets and statement of changes in net assets.

- **The Health Care Security Trust Account (HCST)** is the long - term investment account of the Health Care Security Trust, a minor governmental fund. The Health Care Security Trust was the ultimate recipient of tobacco settlement remittances to the Commonwealth from fiscal year (FY) 99 through FY02. The HCST is managed by a board of trustees, which supervises the investment and reinvestment of monies received into the HCST. The HCST utilizes certain resources and staff of PRIT or PRIM. Certain Medicaid related revenues are also managed by the HCST before expenditure.

- **The Massachusetts Municipal Depository Trust (MMDT)** is an investment pool of the Commonwealth and its political subdivisions. Portions of MMDT are reported as an external investment trust within the fiduciary statement of net assets and statement of changes in net assets. MMDT is established by the Treasurer – Receiver General, who serves as trustee.

The following entities are audited separately from the Commonwealth but are not legally separate from the Commonwealth:

- **The Massachusetts State Lottery Commission,** a division of the Office of the State Treasurer and Receiver – General, operates the Commonwealth's lottery. The net assets of the Commission and results of operations are presented as part of the Commonwealth's governmental activities.

- **The Commonwealth of Massachusetts Owner Controlled Worker's Compensation and General Liability Insurance Program (OCIP)** provides worker's compensation and general liability insurance for all eligible contractors and subcontractors working on the Central Artery / Tunnel Project (CA / T). The OCIP is managed by the Massachusetts Highway Department. The net assets of the program and results of operations are presented as part of the Commonwealth's governmental activities.

The institutions of higher education of the Commonwealth have operations and net assets that are presented as part of the Commonwealth's business – type activities. These systems include:

- **The University of Massachusetts System** including its discretely presented component units, the University of Massachusetts Building Authority, the University of Massachusetts Foundation, Inc., and the Worcester City Campus Corporation (doing business as Umass Health System.) The Worcester City Campus Corporation includes a not-for-profit subsidiary, the Worcester Foundation for Biomedical Research, Inc. Finally, the University System includes the University of Massachusetts Dartmouth Foundation, Inc.

- **The State and Community College System** including the 9 State and 15 Community Colleges located throughout the Commonwealth and the Massachusetts State College Building Authority (a blended component unit). The following are Community Colleges:

- Berkshire Community College
- Bunker Hill Community College
- Bristol Community College
- Cape Cod Community College
- Greenfield Community College
- Holyoke Community College
- Massasoit Community College
- Massachusetts Bay Community College
- Middlesex Community College
- Mount Wachusett Community College
- Northern Essex Community College
- North Shore Community College
- Quinsigamond Community College
- Roxbury Community College
- Springfield Technical Community College

The following are State Colleges:

- Bridgewater State College
- Fitchburg State College
- Framingham State College
- Massachusetts College of Art
- Massachusetts Maritime Academy
- Massachusetts College of Liberal Arts
- Salem State College
- Westfield State College
- Worcester State College

Pursuant to the implementation of GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units, an amendment of GASB Statement No. 14,* in addition to the aforementioned University of Massachusetts System, component units are the following State and Community College System foundations, all of which are legally separate, tax-exempt, separately audited, component units of the various colleges. These entities resources can only be used by or are for the benefit of the various colleges to which they serve. All are presented within the various college financial statements because of the nature and significance of these entities to those colleges. Complete financial statements may be obtained at their various offices.

Community College Component Units:

- Berkshire Community College Foundation
- Bristol Community College Foundation
- Bunker Hill Community College Foundation
- Cape Cod Community College Educational Foundation, Inc.
- Greenfield Community College Foundation, Inc.
- Holyoke Community College Foundation
- Massasoit Community College Foundation
- Massachusetts Bay Community College Foundation, Inc.
- Middlesex Community College Foundation, Inc.
- The Mount Wachusett Community College Foundation, Inc.
- The Northern Essex Community College Foundation, Inc.
- North Shore Community College Foundation
- The Quinsigamond Community College Foundation, Inc.
- The Roxbury Community College Foundation, Inc.
- Springfield Technical Community College Foundation

State College Component Units:

- Bridgewater State College Component Units:
  - The Bridgewater State College Foundation
  - The Bridgewater Alumni Association of Bridgewater State College
- Fitchburg State College Foundation, Inc.
- Framingham State College Foundation, Inc.
- Massachusetts College of Art Foundation, Inc.
- Massachusetts College of Liberal Arts Foundation, Inc.
- The Massachusetts Maritime Academy Foundation, Inc.
- Salem State College Component Units:
  - The Salem State College Foundation, Inc.
  - Salem State College Assistance Corporation
- Westfield State College Foundation, Inc.
- Worcester State Foundation

None of these foundations are considered major component units of the Commonwealth under the definitions put forth under GASB Statement 34, but are blended within their various systems.

Other Discretely Presented Component Units that are Separately Audited **–** Discrete component units are entities which are legally separate (often called Authorities) are financially accountable to the Commonwealth, or whose relationships with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The component units column of the basic financial statements includes the financial data of the following entities:

Major Component Units:

- **The Massachusetts Bay Transportation Authority (MBTA)** provides mass transit facilities within the Greater Boston metropolitan area, comprising 175 cities and towns.
- **The Massachusetts Turnpike Authority (MTA)** operates the Massachusetts Turnpike and the Boston Harbor Tunnel crossings that are part of the Metropolitan Highway System.
- **The Massachusetts Water Pollution Abatement Trust (MWPAT)** provides a combination of federal and Commonwealth funds for water and sewer projects around the Commonwealth as operator of the Commonwealth's State Revolving Fund.

Minor Component Units

- **The Massachusetts Convention Center Authority (MCCA)**
- **The Massachusetts Development Finance Agency (MassDevelopment)**
- **The Massachusetts Technology Park Corporation (MTPC)**
- **The Massachusetts Community Development Finance Corporation (MCDFC)**
- **Commonwealth Corporation**
- **The Massachusetts International Trade Council, Inc. (MITC)**
- **The Community Economic Development Assistance Corporation (CEDAC)**

- **The Massachusetts Housing Partnership (MHP)**
- **Route 3 North Transportation Improvements Association (R3N)**
- **The Commonwealth Zoological Corporation (Zoo)**
- **The Regional Transit Authorities (15 separate entities)** including:
  - Berkshire Regional Transit Authority
  - Brockton Area Transit Authority
  - Cape Ann Transit Authority
  - Cape Cod Regional Transit Authority
  - Franklin Regional Transit Authority
  - Greater Attleboro / Taunton Regional Authority
  - Greenfield-Montague Transportation Area
  - Lowell Regional Transit Authority
  - Martha's Vineyard Transit Authority
  - Merrimack Valley Regional Transit Authority
  - Montachusett Regional Transit Authority
  - Nantucket Regional Transit Authority
  - Pioneer Valley Regional Transit Authority
  - Southeastern Regional Transit Authority
  - Worcester Regional Transit Authority

Related Organizations

The following are "related organizations" under GASB Statement No. 14, *"The Financial Reporting Entity"* as amended by Statement 39: Massachusetts Port Authority, Massachusetts Housing Finance Agency, Massachusetts Health and Educational Facilities Authority and Massachusetts Technology Development Corporation. The Commonwealth is responsible for appointing a voting majority of the members of each entity's board, but the Commonwealth's accountability does not extend beyond the appointments. These entities do not meet the criteria for inclusion as component units of the Commonwealth and therefore are not part of these financial statements.

Availability of Financial Statements

The Commonwealth's component units, departments and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities. To obtain their phone numbers, you may contact the Office of the State Comptroller, Financial Reporting and Analysis Bureau, at (617) 973-2660.

B. Government – Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report information on all non-fiduciary activities of the primary government and its component units. Primary government activities are defined as either governmental or business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues and other non- exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

Government – Wide Financial Statements

The **Statement of Net Assets** presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.

- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation.

- **Unrestricted net assets** consist of net assets, which do not meet the definition of the two preceding categories.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue and offset or supplant the net operating deficit or surplus from governmental or business – type operations.

C. *Fund Financial Statements*

The fund financial statements present a balance sheet and a statement of revenues, expenditures and changes in fund balances for its major and aggregated non-major funds.

Separate financial statements are provided for governmental funds, proprietary funds and fiduciary funds. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with non-major funds being combined into a single column.

D. *Measurement Focus and Basis of Accounting*

The Commonwealth reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

Governmental Activities – Government –wide financial statements - are reported using the economic resources management focus and the full accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

Governmental Funds – Fund Financial Statements - account for the general governmental activities of the Commonwealth. Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual and are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Significant revenues susceptible to accrual include income, sales and use, corporation and other taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services are recognized in the year for which they are levied, grants expended or services provided. Revenues from other financing sources are recognized when received. The measurement period for accrual for taxes generally is one year from the statement of net assets date for income, corporate and other taxes and within thirty days for sales and use taxes, for taxes earned as of June 30, 2005. For federal and other reimbursements, the measurement period for accrual is generally sixty to seventy five days from the statement of net assets date if the related expenditures being reimbursed occurred previous to the statement of net assets date. Expenditures are recorded in the period in which the related fund liability is incurred. Principal and interest on general long-term obligations are recorded as fund liabilities when due.

Business – Type Activities – Government – wide financial statements account for activities for which a fee is charged to external users for goods or services. In these services, debt may be issued backed solely by these fees and charges. There may be also a legal requirement or a policy decision to recover costs. As such, these funds account for operations similarly to a for – profit business. The Commonwealth's Institutions of Higher Education's operations are reported as systems within the proprietary funds. Proprietary fund types are described in more detail below.

Proprietary and Fiduciary Funds – Fund Financial Statements are presented on the same basis of accounting as the business-type activities in the government – wide financial statements.

The Commonwealth reports the following fund types:

Governmental Fund Types:

General Fund, a governmental fund, is the primary operating fund of the Commonwealth. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

Special Revenue Funds account for specific revenue sources that have been aggregated according to Commonwealth Finance Law to support specific governmental activities.

Debt Service Fund accounts for the accumulation of resources for and the payment of debt.

Capital Projects Funds account for the acquisition or construction of major Commonwealth capital facilities financed primarily from bonds and federal reimbursements.

Proprietary Fund Types:

Business - Type Activities account for programs financed in whole or in part by fees charged to external parties for goods and services.

Fiduciary Fund Types:

Pension Trust Funds report resources that are required to be held in trust for the members and beneficiaries of the Commonwealth's pension plans.

External Investment Trust Funds account for the portion of pooled cash and pension assets held under the custodianship of the Commonwealth for the benefit of cities, towns and other political subdivisions of the Commonwealth.

Private Purpose Funds account for various gifts and bequests held by the Commonwealth of which only the income is expendable for purpose specified by the donor. The majority of the individual accounts are for perpetual cemetery care endowments on behalf of deceased individuals. The remaining trust fund in the Massachusetts School Fund, established in 1834 a fund "for the aid and encouragement of common schools." The fund was originally capitalized from the proceeds of the 1820's sale of the public lands upon which the State of Maine was created.

Agency Funds account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Within the governmental fund types, the Commonwealth has established the following funds:

Highway Fund, a governmental fund, accounts for user taxes including the gas taxes and fees to finance highway maintenance and safety services.

Lottery Funds, governmental funds, account for the operations of the State and Arts Lotteries, which primarily finance payments for local aid.

Debt Service Fund, a governmental fund, accounts for the accumulation of resources, principally transfers from other funds, for the payment of long-term debt principal and interest.

Capital Projects - Central Artery Statewide Roads and Bridges Fund, a governmental fund, accounts for the construction of a portion of the Central Artery / Tunnel project financed from FY01 forward, as well as various other statewide road and bridge projects. These expenditures are financed from bond proceeds, certain revenues from Registry of Motor Vehicles fees (net of debt service expenditures) and payments from authorities.

The proprietary funds include the following:

Unemployment Compensation Fund reports the taxes collected from employers and held by the United States Treasury in the Federal Unemployment Trust Fund, from which funds are drawn for the payment of benefits to the unemployed.

College and University Information is presented here, aggregated by the University's activity, the State Colleges activity and the Community College's activity.

Reporting Standards

As allowed by GASB statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Commonwealth's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

Fiscal Year Ends

All funds and discretely presented component units are reported using fiscal years, which end on June 30, except for the Massachusetts Turnpike Authority which utilizes a December 31 year end.

Program Revenue

Program revenue is defined by the Commonwealth to be the revenue from fees and assessments collected by departments that are directly applicable to that department's operations. A corresponding receivable is declared, if applicable.

Revenues and expenses of business type activities and proprietary funds are classified as operating or nonoperating and are subclassified by object. Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

E. *Cash and Short-Term Investments*

The Commonwealth follows the practice of pooling the cash and cash equivalents of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost. Interest earned on pooled cash is allocated to the General Fund, Expendable Trust Funds and, when so directed by law, to certain Special Revenue and Capital Projects Funds.

The Pension Trust Funds, with investments of approximately $37,702,809,000 at fair value and the Health Care Security Trust Account investments of approximately $156,655,000 at fair value, are permitted to make investments in equity securities, fixed income securities, real estate, timber and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentration of credit risk exists if a number of companies in which the fund has invested are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 2005, the estimated fair values, determined by management with input from the investment managers, of these real estate and alternative investments were $7,503,233,000 of the Pension Trust Funds, representing 17.5% of the total assets of the Fiduciary Fund Type.

Pension Trust Fund and External Investment Trust Fund net assets have been restricted as follows:

"Restricted for employee's pension benefits" identifies resources held in trust for the members and beneficiaries of the Commonwealth's pension plans."

"Restricted for external investment trust fund participants" identifies the portion of pooled cash and pension assets held under custodianship of the Commonwealth for the benefit of cities, towns and other political subdivisions of the Commonwealth. The Commonwealth also manages pension assets on behalf of other governments.

The Commonwealth maintains a short-term investment pool. The investments are carried at amortized cost, which approximates fair value. The primary government's and component unit's share are reported as short-term investments within their respective reporting categories. The various local governments and other political subdivisions share of net assets is approximately

$2,115,200,000 and is reported as an External Investment Trust within the Fiduciary Fund Type.

Included in the discretely presented Component Units are investments, whose valuation was determined by management. In making its valuations, management considered the cost of investments, current and past operating results, current economic conditions and their effect on the borrowers, estimated realizable values of collateral, and other factors pertinent to the valuation of investments. There is no public market for most of the investments. Management, in making its evaluation, has in many instances relied on financial data and on estimates by management of the companies they have invested in as to the effect of future developments.

Investments of the University of Massachusetts (UMass) are stated at fair value. Annuity contracts represent guaranteed investment contracts and are carried at present value.

F. *Securities Lending Program*

The Pension Trust funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerarge firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the fair value of the security borrowed. The collateral securities cannot be pledged or sold by PRIT unless the lending agents default. Then lending agents are required to indemnify PRIT in the event that they fail to return the securities on loan (and if the collateral is inadequate to replace the securities on loan) or if the lending agents fail to perform their obligations as stipulated in the agreements. There were no losses resulting from default of the lending agents during the years ending June 30, 2005 and 2004. At June 30, 2005, the fair value of the securities on loan from PRIT was approximately $1,877,595,000. The fair value of the collateral held by PRIT amounted to approximately $1,953,412,000 at June 30, 2005, of which $1,101,100,000 was cash.

G. *Receivables*

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental financial statements to the extent that it is both measurable and available. If revenue is not received by year – end, receivables are declared. Receivables are stated net of estimated allowances for uncollectible accounts. These are the only types of receivables that have allowances.

Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as "Federal grants and reimbursements" or "Due from federal government."

Included in receivables for FY05 are amounts due to the Commonwealth under provisions of the Master Settlement Agreement between five tobacco companies and 46 states, including the Commonwealth. Pursuant to provisions of GASB Technical Bulletin No. 2004-1 "*Tobacco Settlement Recognition and Financial Reporting Entity Issues*", a receivable has been declared for $126.9 million, representing 50% of the amounts estimated to be received in FY05, adjusted for historical trends and included as part of a governmental fund and governmental activities within the statement of net assets.

H. *Due From Cities and Towns*

These amounts represent reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

On July 9, 2004, the Governor signed Chapter 169 of the Acts of 2004, related to the financial ability of the City of Springfield. Section 2 of the Act provides for $52,000,000 in zero interest loans to be drawn from time to time by a finance control board established by the Act. This activity is recorded in the Springfield Fiscal Recovery Trust Fund. The loans are to be paid back to the Commonwealth no later than June 30, 2012. During FY2005, $100,000,000 in cash flow was issued to the City from the Trust Fund. Of this amount, $78,000,000 was repaid to the Commonwealth before June 30, 2005 and the remaining $22,000,000 is reflected as "Due from Cities and Towns." It is anticipated that this revolving activity will continue for the foreseeable future. The Act provides for no forgiveness of the loans and failure to repay the full value of loans disbursed from the fund to the city shall result in an equally commensurate reduction in local aid payments made by the Commonwealth to the City in FY2013.

I. ***Fixed Assets***

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements.

Methods used to value capital assets

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Capitalization Policies

All land, non-depreciable land improvements and donated historical treasures or works of art are capitalized, if cost is greater than $1. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed $50,000 ($1,000 for the University of Massachusetts) are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds $100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Depreciation and useful lives

Applicable capital assets are depreciated using the straight-line method. Unless unallocable, depreciation expense is charged to the function of the capital asset being depreciated. Estimated useful lives are as follows:

Type of Asset	**Estimated Useful Life (in years)**
Buildings	40
Infrastructure - roads, bridges and tunnels	40
Infrastructure - beaches, boardwalks, bikeways, etc.	25
Infrastructure - dams, water and sewer systems	50
Furniture	10
Library collections that are not historical treasures	15
Equipment, office equipment and life safety equipment	10
Computer hardware and software	3 to 7
Vehicles	5

Central Artery / Tunnel Project Depreciation

In FY04 and continuing in FY05, certain Central Artery / Tunnel Project segments were opened to traffic, but not transferred as of June 30, 2005 to the MTA or Massport, as required by general laws. The Commonwealth is reporting these assets as Infrastructure – Central Artery / Tunnel Project and Land – Central Artery / Tunnel Project and has commenced depreciation on these assets. Because amounts are also reported as "Due to Component Units – Central Artery / Tunnel Project" and pursuant to provisions of Massachusetts statutes, the amount claimed on depreciation expense on the Central Artery / Tunnel Project is also an adjustment of the Due to Component Units – Central Artery / Tunnel Project to report the payable at net book value. These activities have no effect on the Commonwealth's statement of activities.

Construction in Process

Construction in process includes all associated cumulative costs of a constructed fixed asset. Construction in process is relieved at the point at which an asset is placed in service for its intended use. For the CA / T, construction in process is relieved upon agreement between the Massachusetts Highway Department, the MTA and / or the Massachusetts Port Authority, its engineers and respective boards. The chief engineer of the Highway Deparment, or their designees, jointly determine and certify to the MTA or the Massachusetts Port Authority that the respective authorities can safely open each such facility or segment thereof to vehicular traffic or that such facility can safely be used for its intended purpose. As of June 30 2005, approximately $1,737,610,000 of project costs has been transferred to the various authorities, including $10,252,000 of costs transferred outside of the current agreements to the Massachusetts Port Authority and $10,697,000 to the Boston Redevelopment Authority.

J. ***Interfund/Intrafund Transactions***

Fixed assets of the Component Units are capitalized upon purchase and depreciated on a straight-line basis over the estimated useful lives of the assets.

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned. Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

K. ***Statewide Cost Allocation Plan – Fringe Benefit Cost Recovery***

The Commonwealth has elected not to present its cost allocation and recovery separately on the statement of activities. Certain costs of nine "central service" agencies of the Commonwealth are recovered from the remaining agencies in a federally approved statewide cost allocation plan. These costs that are allocated are based upon benefits received by the user agency that benefits from these services. The Commonwealth also appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund. These fringe benefits include the costs of employees' group health insurance, pensions, unemployment compensation and other costs necessary to support the workforce. As directed by Massachusetts General Laws, these costs are assessed to other funds based on payroll costs, net of credits for direct payments. Since fringe benefit costs are not separately appropriated or otherwise provided for in these funds, the required assessment creates an unfavorable budget variance in the budgeted funds. The employees' group health insurance and worker's compensation activity is accounted for in the governmental funds.

L. ***School Construction Grants and Contract Assistance Payable***

The Commonwealth, through the MSBA, is committed to reimburse cities, towns and regional school districts for 50% to 90% of approved eligible construction and borrowing costs for school construction and renovation. The MSBA's enabling statute gave the authority responsibility for 728 grant projects under the former school building assistance program of the Commonwealth and 428 waiting list projects. 728 grant project amounts are recorded as current and long-term liabilities in the statement of net assets once all applicable eligibility requirements have been met. Upon completion of the projects, all costs incurred by the grantees are subject to audit by the MSBA and, based on the results of the audits, the approved eligible costs and the related liability may increase or decrease. Completion of these audits by the MSBA will allow the MSBA to determine the final approved cost of these projects, and the MSBA will adjust the payments it makes for these projects in accordance with the results of those audits. The remaining wait list projects are reported as commitments.

The Commonwealth recognizes contract assistance due to MCCA, R3N, MWPAT and MassDevelopment as long-term liabilities on the statement of net assets. These liabilities equate to portions or the whole of certain debt service of these entities. In addition, a payable is declared to the MTA as a cash flow reimbursement for the operations and maintenance of the Central Artery / Tunnel Project.

M. ***Compensated Absences***

Compensated absences are recorded as a long-term liability in the statement of net assets. Short-term compensated absences represent obligations for sick and vacation payments to terminated employees as of June 30, 2005 but paid after the fiscal year end.

For the governmental fund statements, accumulated vacation and sick leave are reported as expenditures and fund liabilities when incurred upon retirement, termination or death.

Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their current rate of pay.

In the business type activity and the discretely presented component units, employees' accumulated vacation and sick leave are recorded as an expense and liability as the benefits accrue.

N. ***Long Term Obligations***

Long-term obligations consist of unmatured long term debt obligations, CA/T assets due to discretely presented component units and related organizations, school construction grants payable (through the MSBA) and contract assistance payable to component units and other liabilities including capital lease obligations and the net pension obligation of the Commonwealth (representing the actuarially derived pension cost in excess of actual contributions made).

O. ***Lottery Revenue and Prizes***

Ticket revenues and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held. For certain prizes payable in installments, the Commonwealth purchases annuities and principal-only and interest-only treasury strips in the Commonwealth's name, which are recorded as annuity contracts and prizes payable in the governmental funds and the governmental activities on the statement of net assets. Though the annuities are in the Commonwealth's name in the case of a default, they are solely for the benefit of the prizewinner. The Commonwealth retains the risk related to such annuities.

P. *Risk Financing*

The Commonwealth does not insure for employees workers' compensation, casualty, theft, tort claims and other losses. Such losses, including estimates of amounts incurred but not reported, are included as accrued liabilities in the accompanying financial statements when the loss is incurred. For employee's workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Massachusetts General Laws limit the risk assumed by the Commonwealth to $100,000 per occurrence, in most circumstances. The Group Insurance Commission administers health care and other insurance for the Commonwealth's employees and retirees.

Q. *Net Assets*

The Commonwealth reports net assets as reserved where legally segregated for a specific future use. Otherwise, these balances are considered unrestricted.

Net Assets have been restricted as follows:

"Restricted for Capital Projects" – identifies amounts of unspent proceeds of capital bond issuances.

"Restricted for unemployment benefits" – identifies amounts solely for payment of unemployment compensation.

"Restricted for retirement of indebtedness" – identifies amounts held by fiscal agents to fund future debt service obligations pertaining to Special Obligation Revenue Bonds authorized under Section 2O of Chapter 29 of the Massachusetts General Laws and Chapter 33, Acts of 1991. It also includes amounts held for Grant Anticipation Notes authorized by Chapter 11 of the Acts of 1997 and Chapter 121 of the Acts of 1998. Escrows related to crossover refundings are also restricted.

"Restricted for central artery workers' compensation and general liability" – identfies amounts held to pay future workers' compensation and general liability claims through the Central Artery / Tunnel Project's owner controlled insurance program.

"Restricted for other purposes" – identifies amounts held for various externally imposed restrictions either by creditors, grantors or laws and regulations of other governments. It also includes various restrictions put forth by the Commonwealth through constitutional or enabling statutes. Included in this restriction are reserves for stabilization and prior appropriations continued.

R. *Reclassifications and Restatement*

Certain amounts in the separately issued Component Units financial statements have been reclassified to conform to the accounting classifications used by the Commonwealth. These amounts are presented as reclassifications in the combining statements for said Component Units. Due to the provisions of GASB Statement No. 34 ("GASB 34") "*Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*", major governmental and proprietary funds presented in a previous year may not be major funds presented in the current year.

S. *New Accounting Standards*

During FY05, the Commonwealth implemented the following new accounting standards issued by the GASB:

Statement No. 40 *"Deposit and Investment Risk Disclosures,"* amends Statement No. 3 *"Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements"*.

For FY06, the Commonwealth will be implementing the following:

Statement No. 42 *"Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries"*.

Statement No. 44 *"Economic Condition Reporting: The Statistical Section, an amendment of NCGA Statement 1"*.

Statement No. 46 *"Net Assets Restricted by Enabling Legislation"*.

Statement No. 47 *"Accounting for Termination Benefits"*.

For Statements 44 and 46, there is no financial impact for these statements. For Statements 42 and 47, as of the date of the opinion, the Commonwealth has not evaluated the financial impact of implementing this statement.

In FY07, the Commonwelath will be implementing Statement No. 45 *"Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*". As of the date of the opinion, the Commonwealth has not evaluated the financial impact of implementing this statement.

2. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature, which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriation acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation. Fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process and are not separately budgeted.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated.

The FY04 General Appropriation Act (Chapter 26, Section 167 of the Acts of 2003), amended section 9C, directing the Governor to notify the Legislature in writing as to the reasons for and the effect of any reductions. Alternatively, the Governor may propose specific additional revenues to equal the deficiency. The Governor may also propose to transfer funds from the Stabilization Fund to cure such deficiency. This proposal must be delivered to the Legislature 15 days before any reductions take effect.

The following table summarizes budgetary activity for FY05 (amounts in thousands):

	Revenues	Expenditures
General Appropriation Act, Chapter 149 of the Acts of 2004:		
Direct appropriations…………	$ 22,548,599	$ 21,281,758
Estimated revenues, transfers, direct appropriations retained revenue appropriations, interagency chargebacks and appropriations carried forward from FY2004 …………	1,438,101	1,818,140
Total original budget…………	23,986,700	23,099,898
Supplemental Acts of 2004:		
* Chapter 352…………	-	(750)
Chapter 462…………	-	350
Chapter 502…………	-	3,271
Supplemental Acts of 2005:		
Chapter 65…………	-	118,544
Chapter 35…………	-	79,568
Chapter 81…………	-	25,000
Total before June 30, 2005 …………	23,986,700	23,325,881
Supplemental Acts of 2005, passed after June 30:		
Chapter 106 …………	-	129,447
Total budgeted revenues and expenditures per Legislative action ……	23,986,700	23,455,328
Plus: Transfers of revenues and expenditures (including rounding)…………	-	1,986,736
Budgeted revenues and expenditures as reported…………	$ 23,986,700	$ 25,442,064

* The negative supplemental appropriation is the outcome of a pilot program implemented at certain state college institutions whereby they were allowed to retain and spend out - of - state tuitions. The offsetting estimated state savings was reduced from the institutions original General Appropriation Act allocation.

As the budget is not passed taking into account the structure of funds, but of appropriations, reports contained within the Commonwealth's MMARS accounting system demonstrate budgetary compliance by appropriation. Those reports are available upon request at the Office of the State Comptroller, Financial Reporting and Analysis Bureau, at (617) 973-2660.

3. DEPOSITS AND INVESTMENTS

Primary Government -

The Commonwealth maintains a cash and short-term investment pool that is available for use by all funds. Each fund type's net equity in this pool is displayed on the combined balance sheet as either "Cash and short-term investments" or "Deficiency in cash and short-term investments." The investments of the Pension Trust Funds are held in a separate trust.

The Treasury manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U.S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by two or more nationally recognized statistical rating organizations and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates fair value.

Pooled cash and short-term investments include the following (amounts in thousands):

	Governmental Activities	Business Type Activities	Government Wide Total
Cash and short-term investments...........	$ 3,747,939	$ 254,166	$ 4,002,105
Cash with fiscal agent............................	1,134,727	-	1,134,727
Total...	$ 4,882,666	$ 254,166	$ 5,136,832

The deficiency in cash is reported as amounts due to other funds in the governmental balance sheet, and as an offset to positive cash account balances in the statement of net assets. Other investments, mainly in escrows, the Pension Trust Funds and the HCST are reported at fair value in the financial statements. The investments of the Pension Trust Funds are held separately from those of other Commonwealth funds, with the exception of their investments in the MMDT. The Pension Trust Funds and the HCST are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. In the following table of interest rate risk – Non-Pension trust funds, which contains investment maturities, these alternative investments, venture capital and futures pools are classified as other investments. The MSBA is authorized to invest similarly to the Treasurer and Receiver – General.

Interest Rate Risk – Non Pension Trust Funds

Interest rate risk is the extent that changes in interest rates of debt investments will adversely affect the fair value of an investment. The following table (in thousands of dollars) provides information about the interest rate risk associated with the Commonwealth's investments, exclusive of its Pension Trust Funds but inclusive of the HCST, which is managed by PRIT. These investments include certain short – term cash equivalents, various long-term items and restricted assets by maturity in years. The Treasury minimizes the risk of the market value of securities falling due to changes in interest rates by maintaining an effective duration of less than 90 days and holding all of the portfolio's total market value in securities with a maturity of six months or less. Because of the short – term nature of these investments, they are defined as cash equivalents. Therefore, they are not investments. The MSBA invests similarly to the Treasury (amounts in thousand of dollars):

		Investment Maturities (in years)			
Investment Type	Fair Value	Less Than 1	One to Five Years	Six to Ten Years	More than Ten Years
Certificates of Deposit	$ 478,447	$ 476,614	$ 1,527	$ 165	$ 141
Yankee Dollars, Foreign Banks	588,227	588,227	-	-	-
Commercial Paper	1,887,178	1,885,178	2,000	-	-
U.S. Government Securities	106,633	18,089	86,797	1,674	73
Federal Agencies	218,406	154,382	42,050	2,372	19,602
Corporate Banks	274,658	107,239	92,006	22,898	52,515
Master Note Agreements	10,847	10,847	-	-	-
Medium Term Notes	570,379	570,379	-	-	-
Repurchase Agreements	426,937	426,937	-	-	-
Guaranteed Investment Contracts	41,421	11,039	30,382	-	-
Annuity and Treasury Strips	1,000,000	-	1,000,000	-	-
Bond Mutual Funds	13,423	5,956	4,662	2,805	-
Other Deposits, Assets and Liabilities, Net	509,846	507,273	1,975	598	-
Total Fixed Income Investments	$ 6,126,402	$ 4,762,160	$ 1,261,399	$ 30,512	$ 72,331

Credit Risk – Non – Pension Trust Funds

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Commonwealth, exclusive of Pension Trust Funds, minimizes concentration of credit risk, the risk attributed to the magnitude of the investment in a single issuer. The Commonwealth's investment policy prohibits the Treasury from investing more than 10% of the total investment portfolio into any single financial institution or issuer, excluding various public entity securities and repurchase agreements. There are no restrictions in the amount that can be invested in public entity securities; however, the portfolio may be invested in U.S. Treasury obligations and repurchase agreements. During FY05, the Commonwealth, exclusive of Pension Trust Funds, maintained an investment with Sovereign Bank, which was valued at 9.1% of the portfolio's total fair value as of June 30, 2005. This investment contains funds in a daily reset account with interest accruing at the London Inter- Bank Offered Rate (LIBOR).

The Treasury requires investments in commercial paper and bankers' acceptances have the highest letter and numerical ranking as rated by nationally recognized statistical ratings organizations as defined by the investment act of 1940. The Treasury does not have any additional policies regarding credit ratings of investments. The following table (in thousands of dollars) provides information on the credit ratings associated with the Commonwealth's investments in debt securities:

		Quality Ratings	
Rated and Unrated Investments	Fair Value	A1 / P1	Unrated
Certificates of deposit	$ 477,785	$ 45,938	$ 431,847
Yankee dollars, foreign banks	588,227	588,159	68
Guaranteed investments contracts	41,421	41,421	-
Commercial paper	1,887,178	1,842,747	44,431
US Government Securities	64,505	64,505	-
Federal agencies	264,438	264,438	-
Corporate bonds	271,349	207,500	63,849
Annuity and treasury strips	1,000,000	1,000,000	-
Bond Mutual Funds	7,883	7,883	-
Master note agreements	10,847	10,845	2
Medium term notes	570,379	570,247	132
Repurchase agreements	426,937	-	426,937
Other deposits, assets and liabilities, net	515,453	5,399	510,054
Total Fixed Income Investments	$ 6,126,402	$ 4,649,082	$ 1,477,320

As of June 30, 2005, the Commonwealth held, at present value, approximately $540 million of annuity contracts and $898 million in US treasury securities on behalf of lottery prize winners. These contracts have maturities ranging from 1 to 30 years. For the annuities, ratings by AM Best range from not rated to AA+. If the annuity contracts default, the Commonwealth is liable for the prize payments.

Interest Rate Risk – Pension Trust Funds

As pension trust funds have a different investment horizon, the PRIM Board manages PRIT's exposure to fair value loss arising from movements in interest rates by establishing duration guidelines with its debt securities investment managers. The guidelines with each individual manager require that the duration of the domestic debt investment portfolio be within a specified percentage or number of years of the duration band of the appropriate benchmark index. For emerging markets fixed income investments, the portfolio must have a duration with a band ranging from three to eight years.

Effective duration is a measure of a fixed income investment's exposure to fair value changes arising from changes in interest rates. Effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows. These assumptions take into consideration factors indicative of investments highly sensitive to interest rate changes, including callable options, prepayments and other factors. These factors are reflected in the effective durations numbers provided in the table below.

The PRIM Board compares the effective duration of a manager's portfolio to the Lehman Brothers Aggregate Index for domestic core "fixed income" securities and the Merrill Lynch High Yield Master II Index for domestic high yield fixed income securities. At June 30, 2005, the following table shows the debt investments by investment type, fair value and effective weighted duration rate (amounts in thousands):

Investment	Fair Value	Effective Weighted Duration Rate *(Years)*
Asset backed securities	$ 198,820	2.08
Commercial mortgage backed securities	142,051	3.66
Non-U. S. Government backed C.M.O.s	56,128	3.92
Commercial paper	62,960	0.11
Corporate bonds and other credits	2,945,971	3.83
U.S. Government bonds	774,531	5.73
U.S. Government agencies	336,781	2.27
U.S. Government TIPS	1,743,098	6.15
U.S. Government mortgage backed securities	1,652,586	2.35
Municipal bonds	16,706	9.72
Pooled money market fund	908,415	0.08
Other pooled funds	790,782	NA
Total fixed income and short-term investments	9,628,829	
Non-fixed income investments	25,524,437	
Total investments at fair value	$ 35,153,266	

Credit Risk - Pension Trust Funds

The PRIM Board establishes credit investment guidelines with each of its fixed income securities investment managers in establishing a diversified portfolio. These guidelines vary depending on the manager's strategy and the role of its portfolio to the overall diversification of the PRIT fund. The guidelines for the PRIT Fund's core fixed income portfolio establish the minimum credit rating for any security in the portfolio and the overall weighted average credit rating of the portfolio. The guidelines for the PRIT Fund's high yield, fixed income portfolio establish a market value range of securities to be held with a specific minimum credit rating and the overall weighted average credit rating of the portfolio.

The weighted quality average rating of the debt securities portfolio, excluding pooled investments, investments explicitly backed by the United States Government and other nonrated investments was A- at June 30, 2005.

The following presents the PRIT Fund's debt securities credit ratings at June 30, 2005 (amounts in thousands):

Investment	Fair Value	Quality Ratings: AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ to Unrated
Asset backed securities	$ 198,820	$ 188,287	$ -	$ -	$ -	$ 10,533
Commercial mortgage backed securities	142,051	134,446	1,028	-	-	6,577
Non-U.S. government backed C.M.O.s	56,128	50,324	-	-	-	5,804
Commercial paper	62,960	60,678	-	-	-	2,282
Corporate bonds and other credits	2,945,971	163,083	146,974	254,539	537,465	1,843,910
U.S. government agencies	336,781	335,301	1,480	-	-	-
U.S. government backed securities	1,566,771	1,502,868	-	-	-	63,903
Municipal bonds	16,706	3,286	4,047	-	9,373	-
Pooled money market fund	908,415		908,415	-	-	-
Other pooled funds	790,782	-	-	-	-	790,782
Total credit risk, fixed income and short-term investments	7,025,385	$ 2,438,273	$ 1,061,944	$ 254,539	$ 546,838	$ 2,723,791
Fixed income investments explicitly backed by the U.S. Government	2,603,444					
Total fixed income and short-term investments	9,628,829					
Non-fixed income investments	25,524,437					
Total investments at fair value	$ 35,153,266					

Foreign Currency Risk – Pension Trust Funds

Foreign Currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments. The Treasury does not have a policy regarding foreign currency risk. The PRIM Board manages PRIT's exposure to foreign currencies by holding a percentage of PRIT's non-U.S. dollar denominated investments to U.S. dollars through forward foreign currency and future contracts. The following table on the next page represents PRIT's foreign currency exposure at June 30, 2005:

	Cash and Short-Term Investments	Equity	Fixed Income	Alternative Investments	Total
Argentine Peso…………	$ 54	$ 326	$ -	$ -	$ 380
Australian Dollar…………	8,827	221,406	776	-	231,009
Brazilian Real…………	1,236	159,214	-	-	160,450
British Pound…………	14,448	1,300,740	4,568	-	1,319,756
Canadian Dollar…………	3	-	1,338	-	1,341
Chilean Peso…………	168	8,778	-	-	8,946
Columbian Peso…………	27	4,088	-	-	4,115
Czech Coruna…………	16	2,833	-	-	2,849
Danish Krone…………	528	59,084	-	-	59,612
Eqyptian Pound…………	1,470	11,247	-	-	12,717
Euro…………	26,676	1,742,675	50,635	-	1,819,986
Greek Drachma…………	4	-	-	-	4
Hong Kong Dollar…………	1,656	270,597	400	-	272,653
Hungarian Forint…………	106	10,424	-	-	10,530
Indian Rupee…………	-	375	-	-	375
Indonesian Rupian…………	26	43,940	-	-	43,966
Israeli Shekel…………	98	17,711	-	-	17,809
Japanese Yen…………	10,297	1,268,502	1,487	-	1,280,286
Malaysian Ringgit…………	896	89,023	-	-	89,919
Mexican Peso…………	29	49,905	-	-	49,934
Taiwan Dollar…………	4,128	174,257	-	-	178,385
Turkish Lira…………	77	42,772	-	-	42,849
New Zealand Dollar…………	538	18,499	-	-	19,037
Norwegian Krone…………	611	27,096	-	-	27,707
Pakistan Rupee…………	-	2,438	-	-	2,438
Peruvian Neuvo Sol…………	-	1,411	-	-	1,411
Philippines Peso…………	104	11,738	-	-	11,842
Polish Zloty…………	102	24,023	-	-	24,125
Russian Rubel…………	-	918	-	-	918
South African Rand…………	500	188,415	14	-	188,929
Singapore Dollar…………	873	75,057	-	-	75,930
South Korean Won…………	1,083	432,351	-	-	433,434
Swedish Krona…………	2,562	170,633	-	-	173,195
Swiss Franc…………	4,186	274,105	-	-	278,291
Thailand Baht…………	78	43,436	-	-	43,514
Alternative investment funds denominated in foreign currencies (various currencies)…………	-	-	-	284,155	284,155
International equity pooled funds (various currencies)…………	-	295,173	-	-	295,173
International fixed income pooled funds (various currencies)…………	-	-	58,424	-	58,424
Total securities subject to foreign currency risk…………	81,407	7,043,190	117,642	284,155	7,526,394
International investments denominated in U.S. Dollars…………	-	808,216	1,139,831	-	1,948,047
Total international investments, deposits and cash…………	$ 81,407	$ 7,851,406	$ 1,257,473	$ 284,155	$ 9,474,441

Concentration of Credit Risk – Pension Trust Funds

The PRIM Board manages PRIT's exposure to concentration of credit risk by establishing guidelines with each investment manager, that limit the percent of investment in any single issue or issuer.

PRIT has no investments at fair value, that exceed 5% of PRIT's net assets held in trust for pool participants as of June 30, 2005.

A. Financial Investments with Off-Balance Sheet Risk

PRIT may invest in other off-balance sheet transactions. These investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. Descriptions of such "off-balance sheet risks" are as follows:

Forward Currency Contracts

The Pension Trust Funds enter into forward currency contracts to hedge the exposure to changes in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates. Risks may arise upon entering these contracts from the potential inability of counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The contract is marked-to-market daily and the change in market value is recorded as an unrealized gain or loss by the Pension Trust Fund.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Fluctuations in the value of forward currency contracts are recorded as unrealized gains or losses by the Pension Trust Funds.

As of June 30, 2005, PRIT had open foreign exchange contracts with combined net unrealized gains of $17,768,000 with various delivery dates to November, 2005.

Futures Contracts

The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owns or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to a percentage of the contract amount.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments, which may correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its future positions due to a non-liquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

The Pension Trust Funds may also invest in financial futures contracts for non-hedging purposes.

Forward Purchase Agreement

During FY02, the Commonwealth entered into a forward purchase agreement with two investment providers to receive investment earnings on grant draws for the payment of the Commonwealth's Grant Anticipation Notes (GANs) principal and interest for the period from June 19, 2002 to July 15, 2014 for note payments approximately six to eleven months after these grant draws. The agreements may only be terminated in the event of a defeasance or refunding of the GANs by the Commonwealth. Should termination occur, the Commonwealth may be liable for a termination amount to be agreed upon between the Commonwealth and the providers at the termination date.

Options

PRIT is also engaged in selling or "writing" options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bear the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 2005, there were no material options outstanding.

Swap Agreements at PRIT and HST

During FY05, PRIT's Core Realty Holdings LLC (a limited liability company inclusive of PRIT and HST – "LLC,") held interest rate swap contracts for the purpose of hedging its floating – rate interest exposure. As of June 30, 2005, PRIT holds 98.99% of the LLC while HST holds the remaining 1.01%. The swap contracts are reported at fair value, which represents their estimated liquidation values (costs) to the LLC. The LLC either receives cash from the swap counterparties or pays the swap counterparties monthly depending on whether the fixed-rate interest is lower or higher than the variable – rate interest. Changes in the fair value of the swap contracts are included in net change in unrealized appreciation on investments and foreign currency transactions, and the income or expense related to settlements of interest under the contracts are included in real estate income, net in PRIT and HST's financial statements.

As of June 30, 2005, the LLC had the following swap contracts in effect (amounts in thousands):

Counterparty	Fixed Rate Paid	Notional Amount	Effective Date	Maturity Date	Fair-Value
Bank of America	4.82%	$ 50,000	07/23/02	07/01/12	$ (2,740)
Citibank, N. A. New York	4.32%	50,000	08/05/02	08/01/06	(991)
Bear Stearns Bank PLC	3.95%	50,000	08/19/02	09/01/07	(248)
Bank of America	4.18%	50,000	12/02/02	12/03/12	(726)
Citibank, N. A. New York	3.68%	50,000	01/01/03	01/01/10	343
Mellon Bank	3.17%	50,000	01/30/03	02/01/08	742
Mellon Bank	3.82%	50,000	03/06/03	06/01/13	523
Bear Stearns Bank PLC	3.45%	50,000	05/13/03	06/01/11	1,217
Citibank, N. A. New York	3.54%	50,000	08/21/03	09/01/08	353
Fleet National Bank	4.34%	50,000	09/22/03	12/01/13	(1,245)
Citibank, N. A. New York	4.11%	50,000	10/27/03	12/01/11	(552)
Bear Stearns Bank PLC	3.37%	50,000	11/24/03	03/01/09	758
Bank of America	4.32%	50,000	12/17/03	06/01/14	(1,167)
Citibank, N. A. New York	3.98%	50,000	04/23/04	06/01/10	(275)
Bear Stearns Bank PLC	5.01%	50,000	05/21/04	12/01/14	(3,926)
Mellon Bank	4.49%	50,000	06/21/04	12/01/10	(1,525)
Citibank, N. A. New York	4.47%	50,000	07/19/04	09/01/12	(1,655)
Bear Stearns Bank PLC	4.44%	50,000	11/16/04	05/01/15	(1,614)
Citibank, N. A. New York	4.17%	50,000	12/20/04	03/01/14	(625)
Citibank, N. A. New York	4.27%	50,000	02/15/05	12/01/15	(865)
Bear Stearns Bank PLC	4.59%	50,000	03/15/05	09/01/13	(2,152)
Bear Stearns Bank PLC	4.42%	50,000	04/21/05	03/01/15	(1,459)
		$ 1,100,000			$ (17,829)

To determine the fair values of its swap agreements, the LLC uses methods and assumptions considering market conditions and risks existing at the date of PRIT's financial statements. Such methods and assumptions incorporate standard valuation conventions and techniques such as discounted cash flow analysis and option pricing models. All methods utilized to estimate fair values result in only general approximations of value, and such values may or may not actually be realized. Fair value estimates are closely correlated with changes in market interest rates and the passage of time. For example, rising market interest rates will generally increase the swaps' termination values to the LLC, whereas termination values are generally reduced as the swaps approach their maturity dates and fewer interest settlements remain under the contracts. As of June 30, 2005, neither the LLC, nor its counterparties expressed intentions to terminate its swap agreements prior to their scheduled maturity dates.

B. Discretely Presented Component Unit Investments

Management of the various discretely presented component units hedge interest rate risk and credit risk differently, dependent on the particular needs and circumstances of each entity. More detailed information may be found in the component units' separately audited financial statements. In the aggregate, interest rate risk and credit risk of the investments of the discretely presented component units at June 30, 2005 are as follows (amounts in thousands):

Investment Type	Fair Value	Investment Maturities (in years): Less Than 1	1-5 years	6-10 years	Over 10 years	Range of Credit Ratings
Forward delivery agreements………………………	$ 241,995	$ -	$ -	$ -	$ 241,995	N/R
Guaranteed investment contracts …………………	1,567,245	133,035	459,878	333,256	641,076	N/R - AAA
Fixed income securities…………………………	146,426	42,512	84,276	19,637	1	N/R - AAA
Repurchase agreements…………………………	23,230	23,230	-	-	-	N/R
Various federal obligations………………………	663,056	319,435	117,380	92,000	134,241	AAA
Corporate bonds…………………………………	21,185	-	17,059	4,126	-	BBB - AAA
Asset backed securities…………………………	10,415	-	1,960	1,131	7,324	N/R - AAA
Auction rate securities……………………………	33,225	33,225	-	-	-	AAA
Total Fixed Income Investments………………	$ 2,706,777	$ 551,437	$ 680,553	$ 450,150	$ 1,024,637	
Other Investments						
Equities…………………………………………	2,673					
MMDT…………………………………………	400,122					
Short - term investment funds……………………	3,219					
Money market mutual funds………………………	350,039					
Total Investments ……………………………	$ 3,462,830					

Custodial Credit Risk-Deposits

Custodial Credit Risk is the risk that in the event of a bank failure the component unit's deposits may not be recovered. The component units do not have deposit policies for custodial credit risk. At June 30, 2005, the carrying amount of deposits totaled $691,544,000 of which $184,351,000 was insured and collateralized and $507,193,000 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Foreign Currency Risk-Investment

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments. The MBTA is subject to foreign currency risk as a result of a cross-border lease transactions that is denominated in Swedish Krona. The transaction allows for a guaranteed exchange rate during the term of the lease. At June 30, 2005 the MBTA's exposure to foreign currency risk amounted to $44,583.

Concentration of Credit Risk – MWPAT

Concentration of credit risk is the risk of loss attributed to the magnititude of a government's investment in a single issuer. MWPAT places no limit on the amount that may be invested in any one issuer. More than 5% of MWPAT's total investments are with the following issuers:

Issuer:	**Percent of total Investments**
SA Capital Management Services, LLC…….	22%
IXIS Funding Corp. …………………………	22%
Societe Generale…………………………….	6%
Trinity Funding Company, LLC……………	18%

Component Unit Swap Agreement Investments

The MBTA has three interest rate swaps and swaptions in order to lower its cost of capital, protect against rising interest rates, lock in interest rate savings, realize refinancing savings according to schedules that suit the MBTA's needs, and to provide the authority with a stable and predictable cost of fuel. At June 30, 2005, the MBTA's swap and swaption transactions had an aggregate notional amount of $300.1 million, termination dates ranging from FY06 through FY22, fixed payable rates ranging from 4.1% to 5.2%, variable receipt rates of either BMA or CPI+79 basis points. On swap has a lump sum payment due from a counterparty in FY07 for $4.4 million, which is recognized as deferred revenue. Counterparty ratings range from A to AAA. The fair value of these investments as of June 30, 2005 was a negative $12.3 million.

In FY99, the MTA entered into an interest rate swap option agreement with Morgan Guaranty Trust Company of New York (MGTC). This "Swaption" agreement runs through July 1, 2029 and carries a notional amount of $100 million. The MTA received a premium payment in FY00 of $5.4 million as part of the agreement. This premium was recorded by the MTA as a deferred credit and is being recongnized as an adjustment of interest expense over the 30-year life of the agreement. MGTC had the right, but not the obligation, to exercise the swap option on January 1, April 1, July 1 and October 1 of any year from July 1, 2002 to July 1, 2029. MGTC had the right to enter the MTA into the swap when the average Bond Market Association Municipal Swap Index (BMA) / London Interbank Offered Rate (LIBOR) ratio exceeds 72% over 12 consecutive months beginning April 1, 2002. The MTA's payment obligation would be equal to the difference between the BMA and 67% of LIBOR, multiplied by the $100 million. Conversely, the Authority may receive payments under this agreement when 67% of LIBOR exceeds the BMA. MGTC exercised its option on October 1, 2002. The MTA received $194,000 of interest in January 2004. The MTA may be exposed to certain risks related to this transaction should the counterparty default.

In FY01, the MTA entered into five interest rate swap options with UBS AG, the Parent Company of UBSPaine Webber (UBS). These swaptions grant UBS the right to enter a swap with the MTA in which UBS would pay a floating rate and receive a fixed rate from the MTA. The swaption exercise dates and fixed rates due from the MTA are designed to match the call provisions and rates of certain of the MTA's bonds. If UBS exercises its option, the MTA expects to refund certain of its fixed rate bonds with floating rate bonds. The floating rate received by the MTA under the swap would provide a hedge for the floating rate due on its refunding bonds. In turn, the MTA's payments to UBS would match the payments expected to be made to fixed rate bondholders. UBS paid $6.2 million on behalf of the MTA during FY01 to purchase insurance for the payments that the MTA may be required to make under the swaps, if exercised. This amount was recorded in the MTA's financial statements as prepaid insurance and is amortized over the life of the swap, which is 35 years.

As of December 31, 2004 the MTA had recorded a long-term receivable of $13.1 million related to the swaption. A corresponding deferred credit totaling $29.1 million was recorded during FY05 related to this transaction. This amount is being amortized over the life of the swap, which is 35 years. The MTA may be exposed to certain risks related to this transaction should the counterparty default.

In FY03, the MTA entered into five interest rate swap option agreements with Lehman Brothers Special Financing Inc. (Lehman). These Swaptions grant Lehman the right to enter a swap with the MTA in which Lehman would pay the MTA a fixed rate of 5% and the MTA would pay Lehman a floating rate of BMA. As a fixed – to – floating swap, the transaction was designed to "offset" the FY01 UBS swaption and, as a result, has the effect of mitigating certain risks inherent in that transaction if both are executed. Lehman paid $6.4 million to the MTA during FY03 and will pay an additional $28.8 million in subsequent years. This amount was recorded in the MTA's financial statements as a deferred credit and will be amortized over the life of the swap, which is 35 years.

A corresponding deferred credit totaling $17.5 million was recorded during FY05 related to this transaction. This amount is being amortized over the life of the swap, which is 35 years. The MTA may be exposed to certain risks related to this transaction should the counterparty default. The unamortized balance as of December 31, 2004 is $35.2 million.

Receivable amounts recorded by the MTA under these agreements are as follows (amount in thousands):

Due January 1,	UBS Amounts	Lehman Amounts
2005................	$ 3,281	$ 5,849
2006................	3,281	5,849
2007................	3,281	5,848
2008................	3,281	-
	13,124	17,546
Less: Current Portion.....	(3,281)	(5,849)
	$ 9,843	$ 11,697

4. RECEIVABLES

Taxes, federal reimbursements, loans and other receivables are presented in the statement of net assets as follows (amounts in thousands):

Primary Government	Taxes Receivable	Federal Grants and Reimbursements	Loans	Other Receivables	Total
Governmental receivables	$ 3,004,666	$ 1,299,254	$ -	$ 1,510,154	$ 5,814,074
Business-type activity receivables	-	35,287	63,487	783,840	882,614
Less: allowance for uncollectibles	(572,331)	(6,712)	(5,468)	(1,360,138)	(1,944,649)
Receivables, net of allowance for uncollectibles	2,432,335	1,327,829	58,019	933,856	4,752,039
Less: current portion:					
Governmental activities	2,432,335	1,292,542	-	304,994	4,029,871
Business-type activities	-	35,287	40,615	591,726	667,628
Noncurrent receivables	$ -	$ -	$ 17,404	$ 37,136	$ 54,540

Discretely Presented Component Units	Taxes Receivable	Federal Grants and Reimbursements	Loans	Other Receivables	Total
Massachusetts Bay Transportation Authority	$ -	$ 19,240	$ -	$ 29,812	$ 49,052
Massachusetts Turnpike Authority	-	-	-	50,462	50,462
Massachusetts Water Pollution Abatement Trust	-	14,418	2,530,324	81,584	2,626,326
Nonmajor component units	-	21,518	317,707	48,584	387,809
Less: allowance for uncollectibles	-	-	18,012	8,442	26,454
Receivables, net of allowance for uncollectibles	-	55,176	2,830,019	202,000	3,087,195
Less: current portion	-	55,176	189,342	166,292	410,810
Noncurrent receivables	$ -	$ -	$ 2,640,677	$ 35,708	$ 2,676,385

5. RECEIVABLES, PAYABLES AND TRANSFERS BETWEEN FUNDS

The purposes of receivables, payables and transfers between funds vary by Legislative authority. Transfers include the following: intergovernmental services, fringe benefit cost assessments, the year-end stabilization transfer, certain license fees collected by the registry of motor vehicles that fund various highway project initiatives, fund closure transfers, transfers from stabilization to fund current operations and various other transfers for operations. Activity between funds reflected as due to / from primary government in the combined balance sheet and various transfers in the combined statement of revenues, expenditures and changes in fund balance as of June 30, 2005 are summarized as follows (amounts in thousands):

Governmental Funds Receiving Fund:	Paying Fund	Amount
General	Highway	$ 51,967
	Lotteries	1,017,637
	Other Governmental Funds	926,411
Highway	Other Governmental Funds	20,751
Debt Service*	General	855,583
	Highway	735,216
	Other Governmental Funds	118,019
Central Artery Statewide Roads and Bridges	Highway	75,316
Other Governmental Funds	General	409,114
	Highway	20,750
	Central Artery Statewide Roads and Bridges	79
	Other Governmental Funds	1,181,619
Total Governmental Funds		5,412,462
Business Type Activities		
General Fund	University of Massachusetts	52,001
	State Colleges	13,603
	Community Colleges	14,623
University of Massachusetts	General Fund	484,615
	Other Governmental Funds	27,386
State Colleges	General Fund	206,085
	Other Governmental Funds	11,644
Community Colleges	General Fund	262,386
	Other Governmental Funds	14,826
Total Business Type Activities (net)		926,715
Total Transfers		**$ 6,339,177**

*Transfers for debt service are net of amounts funded in escrows for crossover refunding debt.

Remaining receivables and payables between funds as of June 30, 2005 largely occur due to the timing of accruals and the funding of escrows. The University also reported unremitted benefits costs as of June 30, 2005. The following is a summary of receivables and payables between funds remaining as of June 30, 2005 (amounts in thousands):

Receivable Fund:	Payable Fund	Amount
Governmental Funds:		
General	Highway Fund	$ 846,155
	Nonmajor Governmental Funds	963,071
Highway Fund	Nonmajor Governmental Funds	-
Central Artery Statewide Road and Bridge Fund	General Fund	377,483
Nonmajor Governmental Funds	General Fund	27,849
Nonmajor Governmental Funds	Nonmajore Governmental Fund	110,563
Total Governmental Funds		**$ 2,325,121**
University of Massachusetts		6,423
Total amounts due		**$ 2,331,544**

Central Artery / Tunnel Project

The Commonwealth is in the final stages of completion in the most expensive public construction project in the history of the United States, the Central Artery / Tunnel Project (CA/T or Project). The project depressed the Central Artery (Interstate 93) through downtown Boston and connected the Massachusetts Turnpike (Interstate 90) through a tunnel under Boston Harbor directly to Logan International Airport. In addition to Commonwealth debt and funds from the Federal Government, the MTA (a component unit) and Massport (a related organization) have contributed to the costs of construction. Once completed, the assets of the project will be transferred to these entities for operations and maintenance.

The Commonwealth has recorded as assets the Commonwealth's construction cost to date for the Central Artery / Tunnel Project, net of amounts transferred to the MTA and Massport. This amount is reflected as "Construction in Process – Central Artery / Tunnel Project". This amount is offset by two corresponding liabilities: "Due to Component Units – Central Artery / Tunnel Project"in the Statement of Net Assets for the MTA's portion and "Due to Other Related Organizations" for Massport's portion. As portions of the project are completed and transferred to either the MTA or Massport in accordance with Massachusetts General Laws, Chapter 81A, these amounts will be reduced for the value of the assets transferred.

The following summarizes the activity for the CA / T for FY05 (amounts in thousands):

Total Project budget as of June 30, 2005	**$ 14,625,000**
Determination of Amounts Payable:	
Cumulative authorized project invoices as of June 30, 2005	$ 13,872,253
Less: Amounts to be transferred to Massport as of December 31, 2004	(365,000)
Less: Amounts transferred previous to December 31, 2004 to MTA and recognized as assets by MTA	(1,716,660)
Less: Amounts transferred to other entities	(20,949)
Subtotal	11,769,644
Less: Reduction of payable due to accumulated depreciation of assets in use to be transferred	(493,977)
Due to Component Units - Central Artery / Tunnel Project as of June 30, 2005	**$ 11,275,667**
Reconciliation of Central Artery / Tunnel Fixed Assets to Assets to Due to Component Units - Central Artery / Tunnel Project as of June 30, 2005:	
Determination of Assets in Use:	
Infrastructure - Central Artery / Tunnel Project	$ 11,324,918
Less: Accumulated depreciation of infrastructure assets in use to be transferred	(493,977)
Net book value of Infrastructure - Central Artery / Tunnel Project	10,830,941
Land - Central Artery / Tunnel Project	459,479
Net book value of Central Artery / Tunnel Project Assets in use to be transferred	**11,290,420**
Construction in process - Central Artery / Tunnel Project	350,247
Subtotal	11,640,667
Less: Due to related organizations (Massport)	(365,000)
Due to Component Units - Central Artery / Tunnel Project as of June 30, 2005	**$ 11,275,667**

6. FIXED ASSETS

Capital asset activities for the fiscal year ended June 30, 2005 are as follows (amounts in thousands):

Primary Government ***Governmental Activities***	July 1, 2004 Beginning Balance	Increases	Decreases	June 30, 2005 Ending Balance
Capital assets not being depreciated:				
Land	$ 685,432	$ 21,935	$ 84	$ 707,283
Land Central Artery / Tunnel Project	442,282	17,934	737	459,479
Construction in process - non - Central Artery / Tunnel Project	1,023,815	341,977	54,064	1,311,728
Construction in process - Central Artery / Tunnel Project	1,244,462	555,546	1,449,761	350,247
Total capital assets not being depreciated	3,395,991	937,392	1,504,646	2,828,737
Capital assets being depreciated:				
Buildings	3,662,981	80,228	11,501	3,731,708
Machinery and equipment	718,851	165,044	98,385	785,510
Infrastructure non - Central Artery / Tunnel Project	10,914,234	10,203	3	10,924,434
Infrastructure - Central Artery / Tunnel Project	9,893,091	1,431,827	-	11,324,918
Total capital assets being depreciated	25,189,157	1,687,302	109,889	26,766,570
Less, accumulated depreciation:				
Buildings	1,679,990	114,416	6,382	1,788,024
Machinery and equipment	597,982	122,696	176,197	544,481
Infrastructure non - Central Artery / Tunnel Project	4,286,330	262,971	-	4,549,301
Infrastructure - Central Artery / Tunnel Project	247,327	246,650	-	493,977
Total accumulated depreciation	6,811,629	746,733	182,579	7,375,783
Total capital assets being depreciated, net	18,377,528	940,569	(72,690)	19,390,787
Governmental activity capital assets, net	$ 21,773,519	$ 1,877,961	$ 1,431,956	$ 22,219,524
Business - Type Activities				
Capital assets not being depreciated:				
Land	59,522	2,511	-	62,033
Construction in process	136,214	342,740	29,232	449,722
Historical treasures	703	26	-	729
Total capital assets not being depreciated	196,439	345,277	29,232	512,484
Capital assets being depreciated:				
Buildings	2,494,296	336,214	59,244	2,771,266
Machinery and equipment	688,942	72,018	15,602	745,358
Library collections, not including historical treasures	124,486	9,378	8,184	125,680
Total capital assets being depreciated	3,307,724	417,610	83,030	3,642,304
Less, accumulated depreciation:				
Buildings	1,366,433	120,588	1,464	1,485,557
Machinery and Equipment	427,816	47,092	397	474,511
Library collections, not including historical treasures	19,247	2,139	727	20,659
Total accumulated depreciation	1,813,496	169,819	2,588	1,980,727
Total capital assets being depreciated, net	1,494,228	247,791	80,442	1,661,577
Business - type activity capital assets, net	$ 1,690,667	$ 593,068	$ 109,674	$ 2,174,061
Total Primary Government capital assets, net	**$ 23,464,186**	**$ 2,471,029**	**$ 1,541,630**	**$ 24,393,585**

Increases to accumulated depreciation differ from depreciation expense as shown on the statement of activities due to the reduction of the payable to net book value of "Due to component unit – Central Artery / Tunnel Project," which is presented as an adjustment to depreciation expense so that the value of the untransferred assets and the amount due to the Turnpike Authority and to Massport always equal.

Depreciation expense was charged to the various functions of governmental activities as follows (amounts in thousands):

Function:		**Amount**
General Government	$	73,030
Judiciary		9,007
Environmental and Recreation		66,310
Housing and Community Development		80
Health and Human Services		19,398
Transportation and Construction		484,860
Education		70,063
Public Safety and Homeland Security		21,951
Economic Development		2,034
Total depreciation expensed		746,733
Less: Amount recognized as an offset to depreciation to equalize the payable to component units and non - component units related to the Central Artery / Tunnel Project		(246,650)
Depreciation charged to governmental activities	$	500,083

Discretely Presented Component Units – Fixed assets consist of the following at June 30, 2005 (amounts in thousands):

Discretely Presented Component Units	July 1, 2004 Beginning Balance	Increases	Decreases	June 30, 2005 Ending Balance
Capital assets not being depreciated:				
Land	$ 488,336	$ 64,791	$ 5,203	$ 547,924
Construction in process	2,249,453	615,396	1,685,335	1,179,514
Total capital assets not being depreciated	2,737,789	680,187	1,690,538	1,727,438
Capital assets being depreciated:				
Buildings	7,939,589	1,435,123	249,228	9,125,484
Machinery and equipment	2,350,917	248,736	38,364	2,561,289
Infrastructure	2,338,075	28,208	487	2,365,796
Total capital assets being depreciated	12,628,581	1,712,067	288,079	14,052,569
Less, accumulated depreciation	4,300,967	393,921	119,547	4,575,341
Total capital assets being depreciated, net	8,327,614	1,318,146	168,532	9,477,228
Discretely Presented Component Unit capital assets, net	$ 11,065,403	$ 1,998,333	$ 1,859,070	$ 11,204,666

7. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Primary Government -

Massachusetts General Laws authorize the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified as a fund liability. Short-term debt may be issued on either a stand-alone basis or through a commercial paper program maintained by the Commonwealth.

A. *General Fund*

The balance of revenue anticipation notes (RANs) outstanding may fluctuate during a fiscal year, but must be reduced to zero at June 30. During FY05, the Commonwealth issued RANs through its commercial paper program on a periodic basis to meet cash flow needs. A maximum of $700,000,000 of RANs were outstanding at any time during the year. All RANs were retired before the end of June 2005.

B. *Capital Projects Funds*

The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects. BANs may be issued either on a stand-alone basis or through the Commonwealth's commercial paper program.

Beginning in FY03 and continuing through FY05, the Commonwealth periodically issued BANs through the commercial paper program. BANs were rolled over and paid down at various times during the fiscal year. No more than $375,100,000 of BANs were outstanding under the commercial paper program at any time during FY05. At June 30, 2005, BANs totaling $140,100,000 remain outstanding.

On March 28, 2002, $180,000,000 in General Obligation BANs were also issued to finance costs of the Central Artery / Tunnel Project, in advance of receiving certain contributions from the Massachusetts Port Authority (Massport). The majority of the BANs were retired previous to FY2005. During June 2003, Massport delivered to the Commonwealth $104,900,000 pursuant to Section 12 of Chapter 81A of the General Laws and the Roadway Transfer Agreement dated as of March 23, 1999, as amended (the "Transfer Agreement") among Massport, the Commonwealth, acting by and through the Massachusetts Highway Department, and the Massachusetts Turnpike Authority. This payment of $104,900,000 was applied to retire a portion of the commercial paper BANs. $75,100,000 of such BANs remains outstanding as of June 30, 2005 and represent a component of the $140,100,000 in BANs outstanding.

On December 31, 2003, Massport was expected to make an additional payment to the Commonwealth under the Transfer Agreement of $50,000,000. This payment was received and applied in August of 2005, leaving a balance of BANs of $25,100,000. A final payment of $50,000,000 was due on December 31, 2004 under the Transfer Agreement only to the extent that Massport has received assets of commensurate value. Massport has informed the Commonwealth that such assets have not been received and that Massport therefore will withhold the final payment until such assets are transferred. Massport and the Commonwealth have not agreed on a scheduled date of payment.

C. *Line-of-Credit Facilities*

During FY05, the Commonwealth maintained line-of-credit facilities to provide liquidity support for commercial paper notes totaling $1,000,000,000. The Commonwealth has a total of five line-of-credit facilities to provide such liquidity support, each in the amount of $200,000,000. These facilities expire in periods from September 2005, through November 2015 at various times, with an optional termination at January 2010. The annual cost of these facilities ranges from 0.12% to 0.16%.

The following schedule details short – term financing and credit agreement activity for all funds for the fiscal year (amounts in thousands):

	Beginning Balance July 1, 2004	Issued / Drawn	Redeemed / Repaid	Ending Balance June 30, 2005	Credit Limit June 30, 2005
General Fund:					
Revenue anticipation notes	$ -	$ 700,000	$ (700,000)	$ -	$ 1,000,000
Line-of-credit agreements	-	-	-	-	-
.					
Subtotal - General Fund activity	-	700,000	(700,000)	-	1,000,000
Capital Projects Funds:					
Bond anticipation notes	75,100	365,000	(300,000)	140,100	-
Subtotal - Capital Projects Funds activity	75,100	365,000	(300,000)	140,100	-
Total short-term financing and credit agreement activity	$ 75,100	$ 1,065,000	$ (1,000,000)	$ 140,100	$ 1,000,000

As of June 30, 2005, no major component units had short – term debt outstanding.

8. LONG-TERM OBLIGATIONS

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit to another entity by a two-thirds vote of the members of each house of the Legislature. The Legislature may not in any manner allow the Commonwealth credit to be given or loaned to or in aid of any individual, or of any private association, or of any corporation, which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 2005, the Commonwealth had two types of long-term debt outstanding, general obligation bonds (inclusive of federal highway grant anticipation notes) and special obligation bonds.

The following is a summary of the Commonwealth's debt outstanding by type of debt (amounts in thousands):

		Amount Outstanding
General Obligation Debt:		
General obligation bonds:		
Fixed rate	$	11,841,879
Variable rate		2,199,795
Auction rate securities		401,500
College opportunity bonds		91,074
County debt assumed		600
Grant anticipation notes (inclusive of cross-over refunding notes)		1,907,340
Discount / (Premium) and issuance cost, general obligations		(33,762)
Subtotal - general obligation debt		**16,408,426**
Special Obligation Debt:		
Special obligation bonds (inclusive of cross-over refunding bonds):		
Fixed rate		1,302,469
Variable rate		183,080
Subtotal - special obligation debt		**1,485,549**
Discount / (premium) and issuance cost		(37,176)
Total outstanding debt	**$**	**17,856,799**

A. *General Obligation Bonds*

General Obligation Bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and Commonwealth supported local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, from which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

In FY05, the Commonwealth sold $500,000,000 in General Obligation Bonds to partially capitalize the MSBA. The proceeds of the debt were used to fund school construction projects throughout the Commonwealth pursuant to changes in the funding of school building assistance initiated during the fiscal year.

In addition, forms of general obligation bonds are issued for specific programs approved by the Legislature. These are as follows:

College Opportunity Bonds

Some Commonwealth general obligation debt is issued in the form of College Opportunity Bonds (COBs) as authorized by the Massachusetts General Laws. These bonds are sold to fund the Commonwealth's "U. Plan" which is part of a college savings program administered by the Massachusetts Educational Financing Authority. These bonds are privately placed and are structured to meet the needs of investors in this plan. Such bonds were initially issued in fiscal year 1996, and have been issued in each subsequent fiscal year, including FY05, during which approximately $11,990,000, (including accretion), of such bonds were issued. Outstanding COBs have maturity dates ranging from 2005 through 2025. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the annual change in the Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total approximately $169,548,000, including accretion. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. The full faith and credit of the Commonwealth back these bonds.

County Debt Assumed

Chapter 38 of the Acts of 1997 and Chapter 300 of the Acts of 1998 abolished governments of several Massachusetts counties on various effective dates. As part of these provisions, the Commonwealth assumed the outstanding debt of Middlesex County on July 1, 1997, of Hampden and Worcester Counties on July 1, 1998, that of Essex County on July 1, 1999 and that of Berkshire County on July 1, 2000. The county debt assumed has become general obligation debt of the Commonwealth. As of June 30, 2005, $600,000 of these obligations remains outstanding.

Variable Rate Demand Bonds

Included in the long-term debt is $2,199,795,000 of general obligation variable rate demand bonds (VRDBs) maturing from 2008 through 2030 in varying amounts, of which $1,924,205,000 is swapped to fixed rates. The redemption schedule for these bonds is included in the bond redemption schedule contained herein. The interest rate on the VRDBs is determined either weekly or daily based on the activity of the Commonwealth's remarketing agents, and interest is paid monthly. On any reset date, holders of the VRDBs can require the Commonwealth (acting through its remarketing and tender agents) to repurchase the bonds (a "put"). The remarketing agent is authorized to use its best efforts to resell any repurchased bonds by adjusting the interest rates offered. The Commonwealth pays an annual fee to the remarketing agents equal to 0.05% of the outstanding par amount of the bonds.

Under the provisions of stand-by bond-purchase agreements entered into by the Commonwealth with certain commercial banks, the remarketing and tender agents are entitled to draw amounts sufficient to pay the purchase price of any bonds that cannot be resold. During any such period, the Commonwealth is required to pay the bank(s) at an interest rate based on their respective prime lending rates. If the remarketing agent is unable to resell any put bonds within six months of the put date, the stand-by bond-purchase agreements include provisions to convert any such bonds to installment loans payable over an extended period of time, with interest payable at a rate based on the bank(s) prime lending rate(s). The stand-by bond-purchase agreements expire on various dates between August of 2005 and December 2015. The Commonwealth is required to renew or replace these agreements as long as the VRDBs remain outstanding. The Commonwealth currently pays an annual fee to maintain these agreements, which range from 0.13% to 0.22% of the par amount of the bonds.

Other Variable Rate Bonds

As part of its refunding activities during FY03, the Commonwealth issued $97,455,000 of refunding bonds which pay a variable rate interest that depends on changes in the Consumer Price Index (CPI). These bonds, which pay interest every six months, are not subject to periodic remarketing, nor do bondholders have the right to "put" such bonds back to the Commonwealth.

On June 29, 2004 as part of the Commonwealth's issuance of the Convention and Exhibition Center Special Obligation Bonds, $86,590,000 of such bonds were issued paying a variable rate of interest also indexed to changes in the CPI. Similar to the 2003 Bonds, the Convention Center Bonds pay interest semiannually, but mature serially from FY15 to FY18.

As detailed in the variable rate debt schedule, these CPI based bonds all have been swapped to fixed rates ranging from 4.45% to 5.25%

Auction Rate Securities

Also included in the long-term debt is $401,500,000 of general obligation Auction Rate Securities (ARS) maturing in varying amounts from 2020 through 2030. The interest rate payable on the bonds changes weekly as determined pursuant to specified auction procedures. Interest on the bonds is payable weekly. In the case of a failed auction (i.e., insufficient bids to clear the market) existing buyers may be required to hold their bonds with interest payable at a rate equal to a percentage of an ARS industry index, up to a maximum rate of 12.0%.

B. *Special Obligation Bonds*

The Commonwealth also issues special obligation revenue bonds as authorized by Massachusetts General Laws. The majority of bonds are secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 2005, the Commonwealth had outstanding $1,458,375,000 of such special obligation bonds, of which

$1,448,372,000 is allocated to debt not subject to the Commonwealth's statutory debt limit. These bonds are secured by a pledge of 6.86 cents of the 21 cent motor fuel excise tax imposed on gasoline.

In March of 2005, the Commonwealth sold $216,765,000 of special obligation revenue bonds, Series 2005A. The bonds generated $25,705,000 of premium. Of the proceeds, $216,725,000 was issued to refund prior special obligation bonds, including $73,495,000 of bonds pursuant to a crossover refunding. The remainder was used to fund capital spending in the Commonwealth. The escrow funded by the refunding bonds and related premium will be used only to secure the principal related to the crossover refunding portion (as well as exclusive of related call premiums.) These particular bonds will mature on June 1, 2008. The interest related to these maturities is not secured by this escrow. Rather, it will be paid from the existing stream of motor fuel excise taxes. Interest on a portion of the newly issued refunding bonds will be paid from the proceeds of the escrow until the aforementioned prior bonds are called for redemption. This crossover refunding results in economic savings to the Commonwealth similar to a normal refunding, but does not meet the accounting definition of defeasance of debt, in which case the defeased debt and the related escrow accounts would have been removed. Until such time as the escrow is used to repay the principal of the refunded bonds, such amounts will be reported in the Highway Capital Projects Fund. Additional special obligation refunding bonds that were the result of crossover refundings, were sold during FY2002. As of June 30, 2005, $389,425,000 from both cross over refundings remained outstanding.

The remainder of unrefunded special obligation debt is attributable to the aforementioned gasoline tax bonds and other bonds that permanently financed the Commonwealth's convention and exhibition centers in Boston, Springfield and Worcester, which are secured by certain taxes collected related to those facilities.

C. *Federal Highway Grant Anticipation Notes*

The Commonwealth also issued Federal Highway GANs to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to $1,500,000,000 in GANs. All Federal Highway Construction reimbursements and reimbursements from the federal highway construction trust funds are pledged to the repayment of the GANs. These notes are secured by the pledge of Federal Highway Construction Reimbursements without a general obligation pledge. Under certain limited circumstances, a portion of the revenue from the Commonwealth's motor fuels excise tax may be used to pay debt service on the GANs.

In July of 2003, the Commonwealth sold $408,015,000 of GANs refunding notes, Series 2003A. These notes are Special Obligations of the Commonwealth. The escrow funded by the notes will be used to secure the principal related to $418,340,000 of GANs, including related call premiums, in previously issued series callable on December 15, 2008 and 2010. The interest related to these maturities is not secured by this escrow. Rather, it will be paid from Commonwealth appropriations or the existing stream of future federal grants. Interest on the newly issued refunding notes will be paid from the proceeds of the escrow until the aforementioned prior notes are called for redemption. For the purposes of the pledge but not for accounting purposes, at the time of call, the refunding notes will become GANs. This results in economic savings to the Commonwealth similar to a normal refunding, but does not meet the accounting definition of defeasance of debt, in which case the defeased debt and the related escrow accounts would have been removed. Until such time as the escrow is issued to repay the principal of the refunded notes, such amounts will be reported in the Grant Anticipation Note Trust Fund. Inclusive of the cross-over refunding notes, at June 30, 2005, the Commonwealth has $1,907,340,000 of GANs outstanding, including accreted interest on capital appreciation bonds with maturity dates ranging from 2006 to 2015.

D. *Interest Rate Swap Agreements*

The Commonwealth enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these agreements, no amounts are recorded in the financial statements.

Objective of the Interest Rate Swap Agreements

In connection with the issuance of variable rate refunding bonds in 1997, 1998, 2001, 2003 and 2005, the Commonwealth entered into interest rate swap agreements with certain counterparties. The purpose of these agreements is to effectively fix the interest rate payable on the corresponding variable rate refunding bonds, and to achieve an all-in synthetic interest rate that is lower than the rate that could have been achieved on a natural fixed rate basis at the time the agreements were entered into.

Terms of the Interest Rate Swap Agreements

The bonds and related swap agreements have final maturities ranging from 2013 to 2028. The swaps' total notional value of $2,107,285,000 matches the par amount of the related variable rate refunding bonds. Under the swap agreements, the Commonwealth pays the relevant counterparties' fixed rates ranging from 2.56% to 5.25% and receives variable rate payments equal to the amount of variable rate payments the Commonwealth pays on the related variable rate refunding bonds.

The following chart details the Commonwealth's outstanding swaps and related bond issuances:

Associated Bond Issue	Notional Amounts (thousands)	Effective Date	Fixed Rate Paid (Range)	Variable Rate Received	Fair Market Values (thousands)	Final Termination Date	Counterparty Credit Rating
General Obligation Bonds:							
Series 1997B……….	$ 162,768	8/12/1997	4.659%	Cost of Funds	$ (15,634)	August 1, 2015	AA+/Aaa
Series 1997B……….	108,512	8/12/1997	4.659%	Cost of Funds	(11,653)	August 1, 2015	AAA/Aaa
Series 1998A & B…	299,712	9/17/1998	4.174%	Cost of Funds	(25,297)	September 1, 2016	AAA/Aaa
Series 1998A & B…	199,808	9/17/1998	4.174%	Cost of Funds	(13,586)	September 1, 2016	AAA/Aaa
Series 2001B & C….	496,225	2/20/2001	4.150%	Cost of Funds	(61,394)	January 1, 2021	AAA/Aaa
Series 2003B………	87,455	3/12/2003	4.500%	Cost of Funds / CPI	(303)	March 1, 2014	AA+/Aaa
Series 2003B……….	10,000	3/12/2003	4.500%	Cost of Funds / CPI	42	March 1, 2013	A/A2
Series 2005A………	559,725	3/29/2005	2.56%-4.00%	BMA	(13,479)	February 1, 2028	AA-/Aa2
Subtotal……………	1,924,205				(141,304)		
Special Obligation Dedicated Tax Revenue Bonds (CPI Based Swaps):							
Series 2004………..	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds / CPI	2,226	January 1, 2018	A/A1
Series 2004…………	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds / CPI	(2,305)	January 1, 2018	A+/Aa3
Series 2004………..	28,863	6/29/2004	4.45% - 5.25%	Cost of Funds / CPI	(2,401)	January 1, 2018	AA-/Aa2
Series 2005A……….	96,490	6/12/2005	4.78% - 5.06%	Cost of Funds / CPI	(5,736)	June 1, 2022	AA-/Aa3
Subtotal…………….	183,080				(8,216)		
Total………………	$ 2,107,285				$ (149,520)		

Fair Market Value of the Interest Rate Swap Agreements

Swap rates for the types and remaining terms of the Commonwealth's swap agreements are generally lower (as of June 30, 2005) than those that prevailed when the various swap contracts were entered into. This is the result of two factors: (1) lower interest rates in general; and (2) the shortening of the remaining terms of the swap contracts due to the passage of time and an upward sloping yield curve for such instruments. As a result, the Commonwealth's swap agreements have an estimated fair market value of negative $149,520,000 as of June 30, 2005. If all the Commonwealth's swap agreements had been terminated as of the end of fiscal year 2005 the Commonwealth would have been required to make a payment of this magnitude. Although the Commonwealth has the option of terminating its swap agreements at any time (and either make or receive any termination payment due), the Commonwealth's counterparties do not have such an option. Therefore, the Commonwealth would only have to make a payment of the magnitude estimated if certain termination events occurred, as described below.

Credit Risk of the Interest Rate Swap Agreements

The swap contracts require that the Commonwealth's counterparties maintain certain ratings levels. If they fail to maintain such ratings, the Commonwealth could choose to terminate the related swap agreement and receive or pay a termination payment depending on the interest rates at the time. Similarly, the Commonwealth is required to maintain a certain credit rating under the agreements, generally in the "A" category. If the Commonwealth's rating fell below those levels, the Commonwealth's counterparties could choose to make variable rate payments based on a market index (instead of the actual bond rate) that would subject the Commonwealth to basis risk, as noted below.

Basis, Market and Rollover Risk of the Interest Rate Swap Agreements

Because the terms on the interest rate swap agreements require the Commonwealth's counterparties to make variable rate payments equal to those the Commonwealth makes on the related variable rate bonds, the Commonwealth is not generally subject to any basis or market risk as a result of these agreements. Under certain circumstances, such as a downgrade of the credit rating of the bonds or the enactment of tax-related legislation which causes the related bonds to trade differently, the swap agreements provide that the Commonwealth's counterparties, may, at their option, pay a variable rate that is based on one or more market indicies such as LIBOR or the BMA swap index. Under these circumstances, the Commonwealth would be subject to basis risk if these indicies varied significantly from the variable rates that were determined for the Commonwealth's variable rate demand bonds through the associated remarketing process.

The swap contracts have the same maturity dates and amortizations as the related bonds. Therefore, the Commonwealth is not subject to any rollover risk as a result of these agreements.

Termination Risk of the Interest Rate Swap Agreements

The swap contracts use the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The swap agreements are not otherwise subject to termination except at the Commonwealth's option. If one or more of the swap agreements were terminated, then related variable rate bonds would no longer be hedged and the Commonwealth would no longer be paying a synthetic fixed rate with respect to the bonds. In addition, if at the time of termination, the swap had a negative fair value, the Commonwealth would incur a loss and would be required to settle with the related counterparty or counterparties at the swaps' fair market values.

The Commonwealth is party to an interest rate swap agreement relating to the Commonwealth's General Obligation Bonds, 2001 Series B and 2001 Series C. The swap documentation provides that the method for determining the floating rate obligation of the counterparty may change upon an "Event of Taxability". The swap counterparty has asserted that an Event of Taxability has occurred and that, as a result, commencing May 3, 2004, the Commonwealth's monthly net payments to the counterparty must be increased. The Commonwealth disagrees with this assertion and, on April 23, 2004, filed a complaint in Suffolk County Superior Court. The swap payment made by the Commonwealth on May 3, 2004 and each monthly payment made thereafter have been calculated based on the pre-existing method. Had they been calculated as asserted by the swap counterparty, under marked conditions on each such payment date through June 1, 2005, the payments would have been approximately $1.7 million greater in the aggregate. The termination value of this swap as of June 30, 2005 is believed to have been approximately $61.4 million in favor of the swap counterparty and will vary from time to time. The Commonwealth has continued to make net swap payments based on its actual variable rate bond payments pending legal developments.

Debt service on the variable rate bonds is as follows (assuming a short term rate of 2.75% and a CPI rate of 3%):

Fiscal Year	Variable-Rate Bonds		Interest Rate	
Ending June 30	Principal	Interest	Swaps, Net	Total
2006…………….	$ 3,245	$ 58,622	$ 30,231	$ 92,098
2007…………….	3,745	58,528	30,235	92,508
2008…………….	6,190	58,376	30,207	94,773
2009…………….	12,030	58,135	30,145	100,310
2010…………….	34,545	57,292	29,784	121,621
2011-2015………	722,010	243,062	124,284	1,089,356
2016-2020………	817,915	119,305	56,807	994,027
2021-2025………	408,650	38,357	17,220	464,227
2026-2030………	98,955	4,487	2,016	105,458
Total	$ 2,107,285	$ 696,164	$ 350,929	$ 3,154,378

E. *Outstanding Debt*

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and accreted interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long-term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Long-term debt outstanding (including discount and issuance cost) and debt authorized and unissued at June 30, 2005 is as follows (amounts in thousands):

Purpose	Bonds Outstanding	Fiscal Year Maturities	Authorized and Unissued
GANs	$ 1,907,340	2006-2015	$ -
Capital Projects:			
General	6,004,267	2006-2031	4,903,055
Highway	8,837,377	2006-2034	3,907,063
Local Aid	1,049,668	2006-2031	593,693
Other	58,146	2006-2029	103,010
	15,949,459		9,506,821
Total	$ 17,856,799		$ 9,506,821

Interest rates on the Commonwealth's debt outstanding at the end of FY05 ranged from 0.0% to 8.0%.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 2005 are as follows (amounts in thousands):

	Bonds Outstanding	Authorized and Unissued
Balance July 1, 2004	$ 17,382,172	$ 6,827,993
General and special obligation bonds:		
Principal, less discount and issuance costs	1,354,226	(1,354,226)
Net premium and issuance costs	(86,945)	-
General obligation refunding bonds:		
Principal on Refunding Bonds	1,296,532	-
Principal on Refunded Bonds	(1,230,673)	-
Retired discount on Refunded Bonds	23,753	-
Increase in bonds authorized	-	4,041,138
Decrease in bonds authorized		(8,084)
Bonds retired	(882,266)	-
Balance June 30, 2005	$ 17,856,799	$ 9,506,821

Business Type Activities – Colleges and University Debt

Building authorities related to the University of Massachusetts and the state colleges have issued bonds for construction of higher education facilities and equipment. Such bonds are guaranteed by the Commonwealth in an aggregate amount not to exceed $200,000,000. The bond agreements generally provide that revenues from student fees are pledged as collateral on the bonds and establish bond reserve funds, bond funds, and maintenance reserve funds. The University of Massachusetts and state colleges have also entered into various loan agreements as participants in the Massachusetts Health and Educational Facilities Authority's (MHEFA) ongoing capital asset program to finance construction projects and equipment.

At June 30, 2005, debt service requirements to maturity for principal (including discount, capital appreciation and issuance costs) and interest including all variable rate interest not hedged by swap agreements (assumed interest rate is 5%) are as follows (amounts in thousands):

Fiscal Year Ended June 30	Governmental Activities General Obligation Principal	Governmental Activities General Obligation Interest	Business - Type Activities Revenue Obligation Principal	Business - Type Activities Revenue Obligation Interest
2006	$ 1,024,522	$ 886,927	$ 31,244	$ 68,717
2007	1,072,597	840,831	35,657	67,484
2008	1,097,010	785,623	44,255	65,804
2009	1,105,235	729,723	45,605	63,809
2010	1,051,320	673,298	47,176	61,781
2011 - 2015	5,283,141	2,549,006	269,098	269,626
2016 - 2020	3,404,067	1,393,035	283,443	213,497
2021 - 2025	2,507,867	599,824	264,490	158,633
2026 - 2030	916,560	240,054	245,952	94,443
2031 - 2035	394,480	31,617	96,740	26,606
2036 - 2040	-	-	32,742	11,187
2041 - 2045	-	-	25,155	2,822
Total long - term debt	17,856,799	8,729,938	1,421,557	1,104,409
Less: Current Portion	(1,024,522)	(886,927)	(31,244)	(68,717)
Long - term debt	$ 16,832,277	$ 7,843,011	$ 1,390,313	$ 1,035,692

The Commonwealth issued bonds and notes through both competitive and negotiated sales during FY05. The costs for legal counsel and underwriting fees for bond sales were $470,000 and $10,209,000 respectively. In addition, the Commonwealth paid $176,000 for disclosure counsel services.

F. *Bonds Defeased Through Refunding*

As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general and special obligation bonds through the issuance of $1,395,377,000 of general and special obligation refunding bonds, inclusive of premiums, during FY05. Net proceeds after issuance costs totaled approximately $1,377,083,000 were used to purchase U.S. Government and U.S. Government Agency securities, which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, with the exception of the aforementioned crossover refunding bonds, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the financial statements. As a result of these refundings, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately $112,274,000 over the next 23 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately $67,273,000. At June 30, 2005, approximately $1,286,720,000 of the bonds defeased and refunded during FY05 remain outstanding.

G. *Prior Defeasance*

In prior years, the Commonwealth defeased certain general and special obligation bonds by purchasing securities (from the proceeds of refunding bonds or from surplus operating funds) and placing them in irrevocable trusts to provide for all future debt service payments on the defeased bonds. Accordingly, exclusive of the aforementioned crossover refunding, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 2005, approximately $5,264,035,000 of bonds outstanding from activities in prior fiscal years are considered defeased.

H. *Statutory Debt Limit*

The Massachusetts General Laws establish limits on the amount of direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for FY05 was approximately $13,463,535,000. Outstanding debt subject to the limit at June 30, 2005 was approximately $12,185,286,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined by statute to include general obligation bonds at the amount of their original net proceeds. It excludes BANs, discount and issuance costs, if any, special obligation bonds, GANs, refunded bonds, certain refunding bonds, debt issued by counties, debt issued in conjunction with the MBTA Forward Funding, certain Central Artery / Tunnel debt and debt issued for the SMART program. The amounts excluded from the debt limit are as follows (amounts in thousands):

		Debt Outstanding
Balance June 30, 2005..	$	17,856,799
Less amounts excluded:		
Premium / (discount) and issuance cost........................		70,937
Special obligation principal...		(1,485,548)
GANs principal…………………………………………		(1,908,015)
Central Artery / Tunnel…………………………………		(1,336,741)
County debt assumed…………………………………		(600)
MBTA forward funding………………………………		(511,546)
SMART bonds for the MSBA…………………………		(500,000)
Outstanding Direct Debt..	$	12,185,286

I. *Changes in Long – Term Liabilities*

Other long-term liabilities will be liquidated in the future from governmental funds. Due to the major restructuring of school construction finance in the Commonwealth that commenced in FY05, a large increase in liabilities occurred. During the year ended June 30, 2005, the following changes occurred in liabilities reported as part of the long-term liabilities in the statement of net assets (amounts in thousands):

Primary Government Governmental Activities	Interest Rates	Maturity Through	July 1, 2004 Beginning Balance	Increases	Decreases	June 30, 2005 Ending Balance	Due Within One Year
Long - term debt:							
General obligation bonds	0.00 - 8.00%	2031	$ 14,127,395	$ 2,406,133	$ 1,999,355	$ 14,534,173	$ 878,062
Special obligation bonds	4.00 - 5.50%	2034	1,347,882	227,497	89,831	1,485,548	28,565
Grant anticipation notes	0.00 - 7.00%	2015	1,908,015	-	-	1,908,015	117,895
Unamortized (premiums) / discounts:							
General obligation bonds			15,491	16,632	65,209	(33,086)	-
Special obligation bonds			(15,936)	495	21,735	(37,176)	-
Grant anticipation notes			(675)	-	-	(675)	-
Total long - term debt			17,382,172	2,650,757	2,176,130	17,856,799	$ 1,024,522
Less: Current portion............			(880,272)	1,024,522	880,272	(1,024,522)	
Net long - term debt			16,501,900	1,626,235	1,295,858	16,832,277	
Other long - term liabilities:							
Due to Component Units - Central Artery / Tunnel Project..................			10,967,508	2,005,307	1,697,148	11,275,667	-
Due to related organizations............			365,000	-	-	365,000	-
MSBA School construction grants payable............			3,259,126	7,015,136	3,259,126	7,015,136	386,908
Contract assistance payable............			333,228	154,482	146,210	341,500	-
Prizes payable............			-	1,437,489	-	1,437,489	
Other liabilities............			644,786	647,296	644,786	647,296	-
Total other long - term liabilities............			15,569,648	11,259,710	5,747,270	21,082,088	386,908
Total non - current liabilities			$ 32,071,548	$ 12,885,945	$ 7,043,128	$ 37,914,365	$ 1,411,430

Business - Type Activities	Interest Rates	Maturity Through	July 1, 2004 Beginning Balance	Increases	Decreases	June 30, 2005 Ending Balance	Due Within One Year
Long - term debt:							
Revenue obligation debt	0.0 - 7.5%	2037	$ 1,049,095	$ 498,248	$ 125,786	$ 1,421,557	$ 31,244
Other long - term liabilities:							
Compensated absences			147,827	17,221	17,556	147,492	92,515
Capital lease obligations............			73,971	45,649	18,024	101,596	19,004
Other liabilities............			85,932	68,829	66,833	87,928	-
Total other long - term liabilities............			307,730	131,699	102,413	337,016	-
Total Long - term liabilities............			1,356,825	629,947	228,199	1,758,573	$ 142,763
Less: Current portion............			(152,050)	142,763	152,050	(142,763)	
Total non - current liabilities			$ 1,204,775	$ 487,184	$ 76,149	$ 1,615,810	

Discretely Presented Component Units – Bonds and notes outstanding at June 30, 2005 (December 31, 2004 for MTA), net of unamortized discounts and premiums, along with unamortized losses on refundings of approximately $93,098,000, are as follows (amounts in thousands):

Discretely Presented Component Units			July 1, 2004 Beginning Balance	Increases	Decreases	June 30, 2005 Ending Balance	Due Within One Year
Major component units:							
MBTA	2.00 - 7.00%	2006-2034	$ 4,504,505	$ 1,139,113	$ 1,063,941	$ 4,579,677	$ 162,695
MTA	3.90 - 5.65%	2006-2039	2,515,738	-	140,805	2,374,933	19,535
MWPAT	2.00 - 6.375%	2006-2035	2,279,395	1,035,524	700,998	2,613,921	111,655
Nonmajor component units	1.77 - 9.00%	2006-2034	1,244,247	54,167	398,689	899,725	55,585
Total bonds payable			10,543,885	2,228,804	2,304,433	10,468,256	349,470
Compensated absences			24,489	20,899	18,577	26,811	19,940
Total Component Units Long Term Obligations			$ 10,568,374	$ 2,249,703	$ 2,323,010	$ 10,495,067	$ 369,410

The amounts below represent the gross face amounts of bonds and notes outstanding and may differ from the amounts included in the combined balance sheet due to treatment of original issue discount in the financial statements. Maturities of principal and interest are as follows (as of December 31, 2004 for MTA) (amounts in thousands):

Fiscal Year Ended June 30.	Massachusetts Bay Transportation Authority		Masschusetts Turnpike Authority		Masschusetts Water Pollution Abatement Trust		Nonmajor Component Units		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2006......................	$ 162,695	$ 226,636	$ 19,535	$ 118,054	$ 111,655	$ 125,935	$ 55,585	$ 49,189	$ 349,470	$ 519,814
2007......................	146,355	235,254	19,890	117,009	114,825	124,822	31,992	41,058	313,062	518,143
2008......................	146,480	229,114	20,555	115,927	117,595	115,641	16,267	40,715	300,897	501,397
2009......................	168,605	220,527	21,620	114,770	120,705	110,225	17,789	39,168	328,719	484,690
2010......................	184,180	211,251	247,195	535,195	124,185	104,543	18,052	38,940	573,612	889,929
2011 - 2015.............	976,255	902,528	279,580	536,827	652,905	434,589	148,558	162,790	2,057,298	2,036,734
2016 - 2020.............	944,040	630,939	355,771	581,908	620,680	261,463	189,608	135,092	2,110,099	1,609,402
2021 - 2025.............	928,545	377,856	299,359	497,061	416,070	120,021	179,843	103,158	1,823,817	1,098,096
2026 - 2030.............	662,680	168,838	124,013	262,998	186,705	45,341	169,236	74,028	1,142,634	551,205
2031 - 2035.............	295,970	34,368	946,285	108,859	84,690	8,549	76,801	6,720	1,403,746	158,496
2036 - 2040.............	16,000	400	142,000	-	-	-	-	-	158,000	400
Total long - - term debt*...........	4,631,805	3,237,711	2,475,803	2,988,608	2,550,015	1,451,129	903,731	690,858	10,561,354	8,368,306
Current portion*........	(162,695)	(226,636)	(19,535)	(118,054)	(111,655)	(125,935)	(55,585)	(49,189)	(349,470)	(519,814)
Long - term debt*.......	$ 4,469,110	$ 3,011,075	$ 2,456,268	$ 2,870,554	$ 2,438,360	$ 1,325,194	$ 848,146	$ 641,669	$ 10,211,884	$ 7,848,492

* Does not include certificates of participation described below.

The MBTA issued certificates of participation (COPs) in the amounts of approximately $28,565,000 on December 15, 1988 and approximately $85,795,000 on August 30, 1990 to finance the purchase of commuter rail coaches. Under the terms of the "Forward Funding" of the MBTA, the COPs payments are not reimbursable by the Commonwealth, but are guaranteed. $1,135,000 of such COPs, bearing interest at 7.75% to 7.80% are due in FY06.

The remaining outstanding principal balance of COPs that were defeased in prior years is $9,075,000 at June 30, 2005.

In prior years, the MBTA defeased in-substance several General Transportation System Bonds by placing the proceeds of new bonds in an irrevocable trust fund to provide for future debt service payments on the old debt. Accordingly, the trust account asset and the liability for the defeased bonds are not included in the accompanying financial statements. On June 30, 2005, approximately $1,940,460,000 of these bonds outstanding are considered defeased.

In FY05 and prior years, the MWPAT defeased in-substance ten series' of Loan Program Bonds similarly to the MBTA. On June 30, 2005, approximately $1,026,215,000 of these bonds outstanding are considered defeased.

Interest Rate Swap Agreements – Discretely Presented Component Units

The MBTA has entered into interest rate swaps and swaptions (referred to herein collectively as Swaps) in order to lower its cost of capital, protect against rising interest rates, lock in rate savings and to realize refinancing savings according to schedules that suit the Component Units' needs. When the Component Unit has entered into Swaps, it has done so in order to: (1) provide lower costs fixed rate financing for its capital needs through synthetic fixed rate structures; (2) lock in long – term fixed rate returns on invested assets in its required reserve funds; and (3) create synthetic refinancing with cash flow savings realized as the Component Unit designates.

Summary of Swap Transactions by Category – Synthetic Fixed Rate Swap Transactions

From FY00 through FY02, MBTA executed swap agreements, associated with particular series of bonds. On one of the agreements, the MBTA will receive a $4,338,000 payment for the counterparty, due in FY07. The transactions are summarized as follows: (amounts in thousands):

Fixed Rate Paid	Variable Receive Rate	Component Unit	Notional Amount	Effective Date	Maturity Date	Fair Value
4.93%……	BMA	MBTA	$ 188,000	June, 2000	2005	$ (741)
5.2%…….	BMA	MBTA	87,805	December, 2001	2022	(9,974)
4.13%……	CPI+79bps.	MBTA	25,005	February, 2004	2020	(1,567)
			$ 300,810			$ (12,282)

Swap Payments and Associated Debt

As of June 30, 2005, debt service requirements on the various bond issuances of the MBTA that have swap payments applied to them were calculated by applying fixed rates ranging from 4.13% to 5.2% and assuming variable rates of 1.02%, using BMA and 4.679% plus 79 basis points for the CPI – based bonds. Debt service related to these swaps is as follows (amounts in thousands).

Fiscal Year Ending June 30,	Variable - Rate Bonds Principal	Variable - Rate Bonds Interest	Interest Rate Swap, Net	Total
2006	$ -	$ 3,324	$ 2,422	$ 5,746
2007	-	3,324	2,422	5,746
2008	-	3,324	2,422	5,746
2009	-	3,324	2,422	5,746
2010	-	3,324	2,422	5,746
2011 - 2015	18,990	16,622	11,157	46,769
2016 - 2020	64,900	16,378	2,963	84,241
2021 - 2023	28,920	4,695	(1,471)	32,144
Total	$ 112,810	$ 54,315	$ 24,759	$ 191,884

Swaptions for Forward Refundings

In addition, the MBTA has four swaptions generally exercisable from FY06 through FY11 on its variable rate general transportation system bonds. The swaptions are summarized as follows (amounts in thousands):

Date of Execution	Notional Amount	Lump - Sum Payment From Counterparty	Counterparty Option Exercise Dates	Term of Swap	Fixed Payable Swap Rate	Variable Receivable Swap Rate	Counterparty Credit Rating as of June 30, 2005	Fair Value at June 30, 2005
* July 2001	$ 188,000	$12,230 (August 2005)	Each March and September from September 2005 through and including March 2010	2030	5.000%	67% of one-month LIBOR	Aa2 / AA+	$ (32,455)
December 1, 2001	79,645	$4,140 (August 2005)	Each March and September from 2009 through and including 2011	2030	5.610%	BMA	Aaa / AAA	(9,836)
June 1, 2005	248,485	N/A	Not a swaption, but a forward swap, effective commenicng December 2, 2006 through July 1, 2030	2023	3.783%	BMA	Aa2 / AA+	(2,269)
June 1, 2005	47,055	N/A	Not a swaption, but a forward swap, effective commencing April 3, 2010 through July 1, 2030	2030	4.132%	BMA	Aa2 / AA+	(514)
								$ (45,074)

*On August 2, 2005, the Authority was notified by USB AG that the option, as described in the swap agreement, will be exercised.

Credit Risk

Because all of the MBTA's swaps rely upon the performance of third parties who serve as swap counterparties, both are exposed to credit risk, or the risk that a swap counterparty fails to perform according to its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swaps. All fair values have been calculated using the Mark to Market or Par Value Method. To mitigate credit risk, the Component Units maintain strict credit standards for swap counterparties. For the MBTA, all swap counterparties for both Moody's and Standard & Poors rate longer-term swaps are in the "AA" category. On the MBTA's swap that matures in FY06, the counterparty is rated in the "A" category by both agencies. To further mitigate credit risk, the MBTA's swap documents require counterparties to post collateral for the MBTA's benefit if they are downgraded below a designated threshold.

Basis Risk

The MBTA is exposed to basis risk if the relationship between the floating index the MBTA receives on the swaps (BMA or 67% of LIBOR) falls short of the variable rate on the associated bonds. Should this occur, the expected savings may not be realized. As of June 30, 2005, the BMA rate was 2.28% while the variable rates on the associated MBTA bonds ranged from 2.22% to 2.60%.

Termination Risk

The MBTA's swap agreements do not contain any out of the ordinary events that would expose them to significant termination risk. In keeping with market standards, all parties may terminate each swap if the other party fails to perform under the terms of the contract. In addition the swap documents allow either party to terminate in the event of a significant loss of creditworthiness. The MBTA views such events to be remote. If at the time of the termination a swap has a negative value, the MBTA would be liable to the counterparty for a payment equal to the fair value of each swap.

Rollover Risk

Only the MBTA's 2000 series bonds are exposed to rollover risk because the swap for the bonds terminates prior to maturity of the bonds. Upon termination of the swap, the MBTA will no longer realize the synthetic rate on the 2000 bonds and will be exposed to floating rate risk on the underlying bonds if no new hedge is put in place.

Market Access Risk and Potential Basis Risk

In the case of the swaptions, other than the FY02 swaption, if any option is exercised and refunding bonds are not issued, the bonds expected to be refunded would not be refunded and the MBTA would make net swap payments as required by the terms of each contract. There is no market acces risk for the FY02 swaption. If any of the options are exercised, the actual savings ultimately recongnized by the transactions will be affected by the relationship between the interest rate terms of the variable rate bonds versus the variable payment on the swap.

9. INDIVIDUAL FUND DEFICITS

Certain funds within the Governmental Fund Type have fund deficits at June 30, 2005. None of these funds were in deficit due to finance-related contractual provisions and were allowed to be in deficit by General Law. The amounts are as follows: (amounts in thousands):

Fund		Amount
Major governmental funds:		
Highway	$	791,461
Other governmental funds:		
Federal Grants		2,302
General Capital Projects		480,142
Capital Expenditure Reserve		98,829
Highway Capital Projects		219,726

10. RETIREMENT SYSTEMS

Primary Government

The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth). The members of the retirement systems do not participate in the Social Security System.

The Commonwealth has assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, granted in fiscal year 1981 to 1996. The Commonwealth performs this valuation on an annual basis.

Plan Descriptions

The *State Employees' Retirement System* (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies, including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

The *Teachers' Retirement System* (TRS) is an agent multiple employer defined benefit PERS. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand-alone financial report.

The *State – Boston Retirement System* (SBRS) is a hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity (BTRS). The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth and is not part of the reporting entity and a stand-alone financial report is not available.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis. During the year ended June 30, 2005, the Commonwealth's pension expenditure included payments totaling $11,631,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

The policy for post-retirement benefit increases for all retirees of the SERS, TRS, BTRS and COLA of local governments is subject to legislative approval.

Membership – Membership in SERS, TRS and BTRS as of January 1, 2005, the date of the most recent valuation, is as follows:

	SERS	TRS	BTRS
Retirees and beneficiaries currently receiving benefits	50,907	42,164	3,155
Terminated employees entitled to benefits but not yet receiving them	3,033	N/A	183
Subtotal	53,940	42,164	3,338
Current employees:			
Vested*	41,432	44,021	3,218
Non-vested*	40,250	44,006	2,562
Subtotal	81,682	88,027	5,780
Total	135,622	130,191	9,118

*Estimated

Benefit Provisions

Massachusetts General Laws establish uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group creditable service, and group classification. The authority for amending these provisions is with the Legislature.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

Funding Progress

During FY01, the Legislature passed Chapter 114 of the Acts of 2000, which modified Chapter 32 of the General Laws. This modification became effective on July 1, 2001. In Chapter 114, teachers who are members of the State Teachers Retirement System, or teachers who are members of the State – Boston Retirement System before 1975, who resigned or took an unpaid leave of absence because of maternity leave will be allowed to "buy back" into the fund up to a maximum of four years. The member must pay the amount determined by the Retirement Board by December 31, 2001 to qualify, as long as the member has worked longer than ten years. If the member completes ten years of service after December 31, 2001, payment can be made within 18 months of completion of ten years of service. In addition, the law creates a superannuation retirement benefit program for all teachers hired on or after July 1, 2001. This program has a contribution rate of 11 percent of regular compensation. To be eligible for the alternative benefit at retirement, the teacher must have completed thirty years of eligible service. All previous members may elect to participate in the program, as long as they participate with the equivalent of a minimum of five years of employee contributions at the new rate. If the member retires before five years, the teacher must pay into the system, the amount that would have been paid in one lump sum, or in installments as the Board may prescribe. The alternative benefit is calculated as the percentage of average compensation determined under the current formula increased by 2% of the average annual compensation for each full year of service in excess of 24 years. The election to participate is irrevocable.

The following table presents the schedule of funding progress as presented in the most recent actuarial valuations at the dates indicated (amounts in thousands):

Actuarial Valuation as of January 1	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employees' Retirement System						
2005	$ 16,211,000	$ 19,575,000	$ 3,364,000	82.8 %	$ 3,967,000	84.8 %
2004	15,931,000	18,966,000	3,065,000	84.0	3,842,000	79.8
2003	13,947,000	17,551,000	3,604,000	79.5	3,779,000	95.4
2002	15,002,000	15,961,000	959,000	94.0	4,034,000	23.8
2001	13,922,000	15,170,000	1,248,000	91.8	3,700,000	33.7
2000	13,364,000	14,138,000	773,000	94.5	3,472,000	22.3
1998	9,914,000	11,361,000	1,447,000	87.3	3,111,000	46.5
1996	7,366,000	9,441,000	2,075,000	78.0	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68.3	2,992,000	91.0
Teachers' Retirement System						
2005	17,683,000	26,167,000	8,483,000	67.6	4,643,000	182.7
2004	17,075,000	24,519,000	7,444,000	69.6	4,556,000	163.4
2003	14,762,000	22,892,000	8,129,000	64.5	4,406,000	184.5
2002	15,712,000	20,620,000	4,908,000	76.2	4,264,000	115.1
2001	14,390,000	18,170,000	3,779,000	79.2	4,072,000	92.8
2000	13,681,000	16,420,000	2,739,000	83.3	3,704,000	73.9
1998	10,170,000	13,095,000	2,925,000	77.7	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	73.7	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	61.9	2,667,000	138.7
State - Boston Retirement System (Boston Teachers)						
2005	1,044,000	2,141,000	1,097,000	48.8	379,000	289.4
2004	1,040,000	2,022,000	982,000	51.4	368,000	266.8
2003	919,000	1,918,000	998,000	47.9	387,000	257.9
2002	984,000	1,756,000	772,000	56.0	370,000	208.6
2001	918,000	1,502,000	583,000	61.1	304,000	191.8
2000	860,000	1,381,000	521,000	62.3	285,000	182.8
1998	699,000	1,219,000	520,000	57.3	285,000	182.5
1996	549,000	1,025,000	476,000	53.6	274,000	173.7
1995	438,000	833,000	395,000	52.6	232,000	170.3

Pension Actuarial Valuation

The Commonwealth's pension actuarial valuation was performed as of January 1, 2005 pursuant to Chapter 32 of the General Laws of the Commonwealth of Massachusetts and based on the plan provisions at that time. The following are the most significant assumptions used in preparing the 2005 actuarial valuation:

Investment return………………………………	8.25% per year
Interest rate credited to annuity savings……….	3.5% per year
Cost of living increases…………………………	3% per year
Mortality………………………………………	RP-2000 Health Annuitant table projected with scale AA (gender distinct). This is applicable to both pre-retirement and post-retirement benefits. Adjustments made for disabled members and certain other groups.
Salary Increases………………………………	Based on analysis of past experience - ranges from 4.75% to 8.5% for groups 1 and 2, 5.5% to 9.5% for group 3, 5.5% to 12% for group 4 and 4.75% to 9.5% for teachers.

Contributions Required and Contributions Made

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

The Commonwealth was financially responsible for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1981 to 1996. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial accrued liability for COLA as of January 1, 2005 was approximately $475,000,000.

The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The Legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and BTRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation. Costs of administering the plan are funded out of plan assets.

Member contributions vary depending on the most recent date of membership:

Hire Date	% of Compensation
Prior to 1975……………………	5% of regular compensation
1975 - 1983………………………	7% of regular compensation
1984 to 6/30/1996…………………	8% of regular compensation
7/1/1996 to present………………	9% of regular compensation except for State Police which is 12% of regular compensation
7/1/2001 to present………………	11% of regular compensation (for teachers hired after 7/1/01 and those accepting provisions of Chapter 114 of the Acts of 2000)
1979 to present……………………	An additional 2% of regular compensation in excess of $30,000

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover BTRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation.

This legislation also directed the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule. Under the current schedule adopted in 2004, the amortization payments are designed to eliminate the unfunded liability by fiscal year 2023 on a 4.50% increasing basis. Contributions by the Commonwealth of $1,216,936,000 were made during the fiscal year ended June 30, 2005. Of this amount $59,520,000 represents payments for COLA granted to participants in retirement systems of cities, towns and counties. The Commonwealth schedule encompasses SERS, TRS and Boston Teachers.

GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost plus amortization of net pension obligation cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution Made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employees' Retirement System								
2005	$ 390,867	$ (102,399)	$ (88,069)	$ 376,538	$ 415,296	$ 1,297,953	106 %	110 %
2004	349,557	(109,346)	(90,749)	330,960	246,754	1,241,195	71	75
2003	397,698	(117,299)	(96,940)	377,338	280,929	1,325,401	71	74
2002	215,795	(111,506)	(92,152)	196,441	266,660	1,421,811	124	136
2001	275,204	(109,731)	(133,387)	298,861	320,381	1,351,592	116	107
2000	352,084	(108,400)	107,190	350,873	367,000	1,330,071	104	105
1999	319,454	(103,188)	98,556	314,822	378,000	1,313,944	118	120
1998	261,255	(83,446)	77,180	254,989	494,289	1,250,766	189	194
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
Teachers' Retirement System								
2005	699,722	(45,553)	(39,178)	693,347	682,000	540,806	97	98
2004	610,841	(65,373)	(54,225)	599,722	359,476	552,153	59	60
2003	651,021	(83,468)	(68,980)	636,534	417,204	792,400	64	66
2002	411,225	(82,377)	(68,079)	396,927	410,143	1,011,729	100	103
2001	475,053	(78,498)	(95,421)	491,976	539,000	998,513	113	110
2000	480,873	(79,487)	78,599	479,985	468,000	951,489	97	98
1999	373,777	(70,312)	67,155	370,620	481,826	963,474	129	130
1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
Boston Teachers Retirement System								
2005	85,679	7,877	6,775	86,800	86,000	(96,279)	100	99
2004	74,787	5,374	4,460	75,701	45,364	(95,480)	61	60
2003	76,151	3,411	2,819	76,743	52,944	(65,142)	70	69
2002	94,003	(67)	(56)	93,992	51,833	(41,343)	55	55
2001	66,820	1,542	1,875	66,488	86,000	815	129	129
2000	58,266	448	(443)	58,271	45,000	(18,697)	77	77
1999	53,453	(989)	944	53,409	36,000	(5,426)	67	67
1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

Net Pension Asset – SERS and TERS

Though the table above presents an actuarily calculated net pension asset for the SERS and TERS, the Commonwealth has elected to reserve 100% against these balances. The funding schedule adopted by the Commonwealth will not eliminate the overall unfunded liability until 2023. These balances are reserved because these net pension assets result from the timing of payments according to the funding schedule and cannot be accessed by the Commonwealth unless the plans are terminated. The likelihood of such an event has been deemed to be remote.

Post-retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately $316,693,000 for the fiscal year ended June 30, 2005. There are approximately 53,334 participants eligible to receive benefits at June 30, 2005.

The Commonwealth has not performed an actuarial valuation of its post-retirement health care and life insurance benefit liability. Private industry typically sees an actuarial accrued liability of 10 to 20 times the current annual payments. For the Commonwealth, this would extrapolate to an actuarial accrued liability of $2.5 billion to $5 billion.

The FY04 General Appropriation Act changed the employee contribution rates for group health insurance, with the exception of current employees earning less than $35,000 and retires. Current employees as of July 1, 2003 will contribute 20% to their health insurance costs if they earn over $35,000. New employees will contribute 25%. In fiscal 2006, the contribution rates will return to 15% for all employees.

11. LEASES

Primary Government

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature.

The Colleges and the University lease real property and equipment under numerous operating lease agreements for varying terms.

The following schedule summarizes future minimum payments under non-cancelable leases for governmental activities and for the Colleges and University – reported as a business-type activity, for the fiscal year ended June 30, 2005 (amounts in thousands):

Fiscal Year Ended June 30	Governmental Activities			Governmental Activities Total	Business - Type Activities			Business -Type Activities Total
	Capital Leases		Operating Leases		Capital Leases		Operating Leases	
	Principal	Interest			Principal	Interest		
2006	$ 21,601	$ 3,276	$ 154,606	$ 179,483	$ 19,004	$ 3,905	$ 14,373	$ 37,282
2007	15,603	2,366	104,792	122,761	17,564	3,099	12,196	32,859
2008	14,046	2,130	76,453	92,629	16,193	2,350	10,749	29,292
2009	5,841	887	58,420	65,148	10,621	1,731	9,028	21,380
2010	5,384	817	40,118	46,319	9,939	1,308	8,431	19,678
2011 - 2015	4,255	645	143,126	148,026	27,935	2,262	17,943	48,140
2016 - 2020	2,227	338	67,707	70,272	340	-	1,018	1,358
2021 - 2025	2,061	312	49,743	52,116	-	-	-	-
2026 - 2030	-	-	46,732	46,732	-	-	-	-
2031 - 2034	-	-	28,039	28,039	-	-	-	-
Total lease obligations	71,018	10,771	769,736	851,525	101,596	14,655	73,738	189,989
Less: current portion:	(21,601)	(3,276)	(154,606)	(179,483)	(19,004)	(3,905)	(14,373)	(37,282)
Long - term lease obligations	$ 49,417	$ 7,495	$ 615,130	$ 672,042	$ 82,592	$ 10,750	$ 59,365	$ 152,707

Discretely Presented Component Units –

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of net minimum lease payments as of June 30, 2005 (amounts in thousands):

Fiscal Year Ended June 30	Massachusetts Bay Transportation Authority	Nonmajor Component Units	Total
2006	$ 45,629	$ 831	$ 46,460
2006	49,700	788	50,488
2007	54,830	5	54,835
2008	49,345	-	49,345
2010	41,305	-	41,305
2011 - 2015	376,519	-	376,519
2016 - 2020	131,719	-	131,719
Lease obligations	749,047	1,624	750,671
Less: Interest portion:	(200,464)	(94)	(200,558)
Present value of minimum lease payments	548,583	1,530	550,113
Less: current portion	(15,490)	(765)	(16,255)
Long - term lease obligations	$ 533,093	$ 765	$ 533,858

The MBTA has entered into several sale-leaseback agreements with major financial institutions, covering equipment and rolling stock, which has been accounted for as operating leases. These leases expire through fiscal year 2013. Upon termination, the MBTA may purchase the equipment and rolling stock at prices equal to the lesser of a stated percentage (40%-70%) of the lessor's original purchase price or residual fair market value, as defined.

The MTA has operating leases for administrative office space and automatic toll collection equipment. These operating leases expire on various dates through June 2006. Lease expenses charged to the Massachusetts Turnpike and Sumner-Callahan-Williams Tunnels were approximately $953,000 of which $855,000 was paid to the Commonwealth for office space in a state-owned building.

The MTA leases property and air rights to others. The MTA earned approximately $32,400,000 in rental income of which $16,500,000 was received for restaurant, concessions and service station rentals.

The future minimum rental payments required under operating leases having initial or remaining non-cancelable lease terms in excess of one year are as follows (as of December 31, 2004 for the MTA) (amounts in thousands):

Fiscal Year Ended June 30	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Nonmajor Component Units	Total
2006	$ 16,636	$ 437	$ 15,403	$ 32,476
2007	16,396	-	15,243	31,639
2008	13,766	-	14,693	28,459
2009	13,466	-	14,829	28,295
2010	13,297	-	14,779	28,076
2011 - 2015	27,584	-	1,974	29,558
2016 - 2020	-	-	337	337
2021 - 2025	-	-	74	74
2026 - 2030	-	-	48	48
Total lease obligations	$ 101,145	$ 437	$ 77,380	$ 178,962

12. COMMITMENTS

A. *Commitments to Discretely Presented Component Units and Other Entities*

The Commonwealth is obligated to dedicate a sales tax amounting to 1% of applicable sales in the Commonwealth, directly to the MBTA to fund its operations. The dedicated sales tax equals to the greater of the amount raised by the sales tax or a defined base revenue amount, subject to an adjustment for inflation, capped at 3% annually. For FY06, the base revenue is approximately $712,586,000.

In FY05, the legislature began phasing in a dedication of sales tax revenues amounting to 1% of applicable sales. $395,700,000 of dedicated sales tax revenue was pledged to fund school construction via a transfer to the MSBA. This amount rises to a minimum of $488,700,000 or 70% of dedicated sales taxes, whichever is larger in FY2006. In future years these amounts rise further per statute until 1% of applicable sales is pledged in FY2011.

Under the MSBA enabling statute, the MSBA is committed to paying for its share of projects on a “Waiting List” once communities meet all applicable eligibility requirements for receiving such grants. The amount of commitments outstanding for these Waiting List projects that are not reflected as MSBA school construction grants payable is $1.1 billion.

Other major dedicated tax revenue streams include surcharges from areas contiguous to convention centers to support such centers’ operations, motor fuels taxes to support highway construction, repairs and maintenance and cigarette taxation to support health and human service costs. The Commonwealth continues to guarantee certain Massachusetts Bay Transportation Authority (MBTA) debt outstanding at June 30, 2005, totaling $1,791,835,000.

At June 30, 2005, the Commonwealth had commitments of approximately $418,930,000 related to ongoing construction projects. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort).

In addition to the residual obligations of the MBTA, the Commonwealth guarantees debt of a number of Public Authorities. At June 30, 2005, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately $1,569,206,000, of which $687,310,000 is for the Route 3 North Transportation Improvements Association and $642,390,000 is for the University of Massachusetts Building Authority.

B. *Saltonstall Building*

The Massachusetts Development Finance Agency (MDFA) was authorized in legislation to undertake redevelopment of the Saltonstall State Office Building and its surrounding area. Under the provisions of MDFA's bond authorization, the building is to be leased by the MDFA for a lease term of up to 50 years with extension terms permitted for an aggregate 30 more years. The MDFA renovated the building and leases half of it back to the Commonwealth for office space and related parking for a comparable lease term. The remainder of the building and surrounding area has been redeveloped as private office space, housing and retail establishments. The Commonwealth is obligated for future lease payments for space it rents. However, this obligation is not a general obligation or a pledge of credit of the Commonwealth. Though MDFA's bonds are revenue obligations, with pledges of the public and private lease payments, the Commonwealth's lease payments are subject to annual appropriation.

C. *Central Artery / Tunnel Project*

The Central Artery / Tunnel Project is the largest single component of the Commonwealth's capital program according to the projects finance plan filed as of October 1, 2004. The current cost estimate is $14.625 billion, of this amount all but $753 million has been expended. The plan includes a maximum obligation of $8.549 billion from the federal government. The finance plan is currently under review.

D. *Pension Trust Funds*

At June 30, 2005, PRIT had outstanding commitments to invest approximately $1,797,000,000 in alternative investments and $155,535,000 in distressed debt. The fair value of the proposed investment commitments approximates their stated value.

E. *Commitments of Discretely Presented Component Units*

As of June 30, 2005, the Massachusetts Water Pollution Abatement Trust (MWPAT) has agreed to provide loans of $35,400,000 to various local government units to be funded with grant awards.

The MTA entered into construction contracts for the Metropolitan Highway system and the Western Turnpike with various construction and engineering companies. Construction contracts outstanding at December 31, 2004 approximated $14,600,000.

F. *Boston Housing Authority West Broadway Homes Project*

In FY04, the Boston Housing Authority (BHA) issued $10 million of housing project bonds to finance a portion of the costs of construction of a lower income public housing project in South Boston. A captive non-profit corporation of the BHA will own and operate the project. The Commonwealth has agreed in the form of contract assistance to subsidize these bonds as part of other subsidies provided to the BHA for its normal operations, subject to appropriation. A portion of the bonds may be redeemed by advance additional grant funds to the

BHA on December 1, 2006, to the extent the project has failed to demonstrate budgeted revenue sufficiency by that date. Thereafter, the bonds will be secured by and payable solely from an assignment of Commonwealth operating subsidy fund to the BHA allocable to the project as well as other funds available to the BHA.

13. CONTINGENCIES

Primary Government **-**

Governmental Funds – The General Fund services claims for all risks of loss for which the Commonwealth is exposed, other than workers' compensation and employee group health and life insurance, which are managed in its general operations. A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated, or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately $30,000,000 as of June 30, 2005. The governmental funds only report the amount of claims and judgments estimated to be probable. However, for government – wide purposes, claims and judgments are reported on a full-accrual basis based on the probability that a loss has been incurred and if the amount can be reasonably estimated.

The General Fund allocates the cost of providing claims servicing and claims payment by charging a premium to each fund based on claims paid during the year. The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund that received the assistance. As of June 30, 2005, the Commonwealth estimates that liabilities, if any, which may result from such audits are not material.

The Commonwealth's abandoned property law requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets, less $3,355,000 that is expected to be reclaimed and paid in fiscal year 2006, are to be remitted to the General Fund each June 30, where it is included as a transfer. Amounts remitted during fiscal year 2005 totaled approximately $172,502,000. Since inception, approximately $1,492,533,000 has been remitted. This represents a contingency, because claims for refunds can be made by the owners of the property.

A. *Tobacco Settlement*

A Master Settlement Agreement (MSA) was executed in November of 1998 between five tobacco companies and 46 states, including the Commonwealth. The MSA called for, among other things, annual payments to the states in perpetuity. These payments have been estimated to total more than $200 billion over the first 25 years, subject to various offsets, reductions, and adjustments.

In FY05, the Commonwealth received approximately $257,417,000 or 91% of the estimated amounts shown in the MSA. All received amounts were transferred to the General Fund.

In FY04, a Suffolk Superior Court jury rejected the claims of the Commonwealth's private tobacco attorneys that they should be paid a fee amounting to 25% of the Commonwealth's tobacco settlement money. The jury awarded the plaintiffs 10.5% of the amount the Commonwealth receives under the MSA through 2025. To date, however, the attorneys have received more than 10.5% of what the Commonwealth has received under the MSA. As of June 30, 2005, the Commonwealth owes nothing under the jury award. Whether the Commonwealth will in the future be required to pay any sum on private counsel's claim will depend on the actual payments received by the Commonwealth under the MSA through 2025, as well as on the amounts the attorneys receive through the arbitration payments.

One of the adjustments discussed above has been called into question and is in the process of being adjudicated. Under the MSA, payments made by the Original Participating Manufacturers ("OPMs") and subsequent Participating Manufacturers (collectively the Participating Manufacturers or "PMs") are subject to a number of adjustments. One such adjustment is the Non-Participating Manufacturer ("NPM") Adjustment, which can be triggered if the OPMs suffer a specified market share loss. Because the OPMs did suffer the requisite market share loss, the OPMs are seeking to reduce, by $1.1 billion (or 18.6%), the $6.2 billion payment they made to the States for 2003. Under the MSA, a nationally recognized economic firm selected jointly by the States and the OPMs must make a determination that "the disadvantages experienced" by the PMs as a result of complying with the MSA were "a significant factor contributing to the Market Share Loss" for 2003. This proceeding got underway in June 2005. The preliminary determination is expected by February 20, 2006, and the final determination is expected by March 27, 2006. It is anticipated that, should the OPMs prevail, they will withhold approximately $1.1 billion from the April 2006 MSA payment to the States, which would likely reduce the initial 2006 MSA payout to Massachusetts by approximately $45-50 million. The $1.1 billion withheld will still be subject to a showing that the States did not "diligently enforce" their individual NPM Escrow Statutes. If Massachusetts proves that it did diligently enforce its NPM Escrow Statute, the $45-50 million withheld will have to be released to the Commonwealth. If Massachusetts fails to prove that it diligently enforced its NPM statute, then the April, 2006, MSA payment to Massachusetts would be permanently reduced by the $45-50 million withheld, or by potentially some greater amount, yet to be determined, depending upon the outcome of the proceedings in other states.

B. *Workers' Compensation and Group Insurance Liabilities*

Workers' Compensation is managed as part of the course of the Commonwealth's general operations. No separate fund for workers' compensation is provided for in Massachusetts General Laws. Claims for compensation are not separately insured and are funded by the Commonwealth only when incurred. Such losses, including estimates of amounts incurred, but not reported are included as accrued liabilities in the accompanying financial statements when the loss is incurred. The Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury, Massachusetts General Laws limit the risk assumed by the Commonwealth to $100,000 per occurrence, in most circumstances.

Based on actuarial calculations as of June 30 2005, discounted, the Commonwealth is liable for unfunded claims and incurred but not reported claims totaling $312.6 million, which is reported in accrued liabilities in the Governmental Activities.

Changes in the Commonwealth's liability relating to workers' compensation claims in FY05 were (amounts in millions):

Claim liability, beginnng of year	$	302.2
Increase in liability estimate		62.8
Payments and decreases in liability estimate		52.4
Claims liability, end of year	$	312.6

The Group Insurance Commission (GIC), a department of the Commonwealth, manages health insurance claims of the Commonwealth's active and retired employees. The Commonwealth is self-insured and various health insurance providers provide health care services to the employees. The accrued liability is estimated based on data provided to the GIC by the insurance companies who participate in the self-insured plans.

Based on GIC estimates, the Commonwealth is liable for an amount of $63.9 million. Changes in the Commonwealth's liability relating to Group Insurance claims in FY05 were (in million):

Claim liability, beginnng of year	$	37.4
Increase in liability estimate		873.0
Payments and decreases in liability estimate		846.5
Claims liability, end of year	$	63.9

C. *Central Artery/Tunnel Project*

Owner Controlled Insurance Program (OCIP)

The Commonwealth of Massachusetts has assumed responsibility for providing worker's compensation and general liability insurance for all eligible contractors and subcontractors working on the Central Artery/Tunnel Project by establishing an Owner Controlled Insurance. The Highway Department established a trust managed and administered by an independent third party (trustee) to protect a portion of the assets set aside with the insurance carrier to fund project liabilities.

The amounts in the Trust are restricted by its terms and cannot be used for other purposes. The withdrawals, other than those to cover costs specified by the Trust Agreement, require mutual consent. During FY03 federally funded fund assets were replaced by state assets and therefore are no longer restricted as to the ultimate distribution at the end of the Project. The insurance coverage provided by the Commonwealth currently extends through June 30, 2006.

The Project's OCIP activity is reported as a minor governmental (capital project) fund. The "Claims and Judgements" liabilities reported within the fund represents the Project's liabilities as estimated by an independent actuary for incurred losses projected to their ultimate value as of the end of the fiscal year for FY05. The remaining liability is reported as part of the non-current liability in the statement of net assets.

As of June 30, 2005, the OCIP has accumulated approximately $167,933,000 in assets that consist of approximately $134,642,000 in cash and investments, approximately $32,373,000 in funds held by the investment provider and approximately $918,000 in interest income receivable. Net assets at year – end of approximately $59,234,000 were restricted for workers' compensation and general liability claims.

The OCIP's assets are to be available to pay the obligations under the programs. These insurance programs are presently structured as retrospectively rated insurance programs with retained loss limits of $1,000,000 per claim, $3,000,000 per occurrence for worker's compensation and $2,000,000 per contractor, $6,000,000 per occurrence for general liability coverage. The Commonwealth is responsible for loss costs up to these amounts.

The estimated Claims and Judgements liability for the OCIP for occurrences through June 30, 2005 is $100,900,000, of which $27,900,000 is presented as a current liability in the minor governmental fund, while the remaining $73,000,000 is presented on the statement of net assets. This amount is based on the results of a review performed by an independent actuarial firm retained by the Project, and it represents an estimate of liabilities incurred based on past experience for claims reported and not reported as of June 30, 2005.

Central Artery / Tunnel Project Leaks and Contractor Difficulties

Financial difficulties could affect the ability of a contractor to complete CA/T Project contract work. If an affected contractor with significant critical path contract work toward an overall project completion milestone were to become insolvent, or otherwise fail to complete its contract work, it is possible that there would be a substantial or material impact on CA/T Project schedule and cost, although the likelihood and potential severity of such impact diminish as the CA/T Project progresses towards completion.

The Turnpike Authority is monitoring particular CA/T contractor's progress with respect to its obligations under CA/T Project contracts and its continuing ability to complete those obligations on an ongoing basis. The contractor continues to progress its work on the CA/T Project, and the Turnpike Authority has not received information that the contractor's financial status will prevent its contractual obligations from being met or the CA/T Project from being completed in accordance with the current schedule.

In addition, the Project has had some water infiltration problems in the project's tunnels. The Turnpike Authority and project staff have indicated that the tunnels have been surveyed, flaws have been identified, and remedies have been designed and are being implemented, including the repair of flaws in tunnel walls and the sealing of leaks at a large number of tunnel wall and roof interfaces. Amounts spent and anticipated to be spent by the CA/T Project for these purposes are expected to fall within the $14.625 billion finance plan. A continuing program to identify and seal leaks will, however, be necessary indefinitely. This program and any additional maintenance and repairs necessitated by continuing infiltration will require higher maintenance costs in the future. The Turnpike Authority has estimated that it will assume responsibility for ongoing leak repairs from the project and its contractors in

2007 at an initial cost of $1.3 million for that year declining to $156,000 in 2010 and thereafter, excluding inflation. An independent evaluation has suggested that, based on current productivity compared to that assumed in the Turnpike Authority's estimate, the cost could be double the amount projected and warns that the estimate is based on experience with the ongoing leak repair program for the Callahan Tunnel, which does not share the CA/T's slurry wall construction. The Turnpike Authority's current operation and maintenance budget does not specifically include amounts for leak repairs and maintenance.

MassHighway Safety Review. On March 15, 2005 the Governor directed the Executive Office of Transportation and the Massachusetts Highway Department to conduct an examination of the safety of the tunnel elements of the CA/T Project open to traffic. This examination is ongoing.

Federal Safety Review. In December 2004 a team of Federal Highway Administration (FHWA) experts from around the United States, including geotechnical and hydraulics experts and structural engineers, conducted a tunnel leak assessment of the CA/T Project. On April 4, 2005, FHWA Administrator Mary E. Peters wrote to the Chairman of the Turnpike Authority, stating that the FHWA had completed its interim leak assessment report and stating: "In summary, FHWA found that the CA/T is structurally sound and remains safe for traffic." The letter further stated that the FHWA will issue another report upon completion of slurry wall inspections, sealing of low-level leaks and repair of slurry wall defects.

As a whole, at this time, the Commonwealth has not independently assessed the extent of the leaks or to what extent a liability, if any for these repairs, would accrue to the Commonwealth.

D. ***Claims and Judgments***

The following amounts were recognized as of June 30, 2005 (amounts in thousands):

	Balance as of July 1, 2004	Additions	Reductions	Balance as of June 30, 2005
Short-term………………	$ 37,750	$ 45,074	$ 24,924	$ 57,900
Long-term………………	82,700	-	9,700	73,000
	$ 120,450	$ 45,074	$ 34,624	$ 130,900

E. ***Discretely Presented Component Units***

The MBTA reserves self-insurance liabilities as claims and judgements as of June 30, 2005. Changes in the self-insurance reserves in fiscal 2005 and 2004 were as follows (amounts in thousands):

	2005	2004
Liability, beginning of year…………………	$ 89,106	$ 88,837
Current year claims		
and changes in estimates…………………	129,679	128,281
Claims payments……………………………	(122,857)	(128,012)
Liability, end of year………………………	$ 95,928	$ 89,106

14. SUBSEQUENT EVENTS

On August 15, 2005, the MSBA issued $2.5 billion of Dedicated Sales Tax Bond (the Bonds). The Bonds mature at various dates through FY31. The interest rates on the Bonds range from 3% to 5%. The Bonds will primarily be used to fund grants to cities, towns and regional school districts for school construction and renovation projects. These Bonds are secured by the Dedicated Sales Tax as discussed in footnote 1A.

On October 18, 2005, MWPAT issued approximately $294 million of Pool Program Bonds, Series 11. These bonds were used to fund 92 loans in MWPAT's Clean Water, Safe Drinking Water and Community Septic Management Program (Title 5) programs.

Subsequent to year-end, the MBTA issued $425 million in Series 2005A Assessment Bonds. Maturity dates are from FY07 through FY36. The bonds were used to refund approximately $113 million of bond anticipation notes with the remainder fudning system-wide improvements, vehicle replacements and a commuter rail expansion project.

In August 2005, the MBTA entered into a forward starting swap with Bear Stearns Financial Products, Inc., for a notional amount of $280 million, equal to the approximate par amount of sales tax bonds anticipated to be issued in January 2007. The proceeds of such bonds will be used to finance system-wide improvements, vehicle replacement and computer tail expansion. The swap is effective commencing January 10, 2007 and the MBTA will receive variable rate equal to the BMA index and pay a fixed rate of 4.158%.